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No. 15979

United States
Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

CHARLES H. RUTHERFORD, Claimant of One 1957 Cadillac "62" Coupe De Ville, etc.,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California Central Division

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-13-58

No. 15979

United States
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for the Ninth Circuit

UNITED STATES OF AMERICA,

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vs.

CHARLES H. RUTHERFORD, Claimant of One 1957 Cadillac "62" Coupe De Ville, etc.,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California Central Division

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—5-30-58

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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Katayama, Arthur S.
—direct 18

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NAMES AND ADDRESSES OF ATTORNEYS

For Appellant:

LAUGHLIN E. WATERS,
United States Attorney;

BURTON C. JACOBSON,
Assistant U. S. Attorney.

For Appellee:

MURRAY M. CHOTINER,
202 So. Hamilton Drive,
Beverly Hills, California.

United States District Court, Southern District of California, Central Division

Civil No. 1392-57—TC

UNITED STATES OF AMERICA,

Libelant,

vs.

ONE 1957 CADILLAC "62" COUPE DE VILLE, License No. MLR 406, Motor No. 5762028343, Its Tools and Appurtenances,

Respondent.

LIBEL OF INFORMATION

The United States of America, through Laughlin E. Waters, United States Attorney for the Southern District of California, respectfully shows:

First Count

I.

That prior to and on or about August 15, 1957, at Compton, County of Los Angeles, within the Central Division of the Southern District of California, and within the jurisdiction of the United States and of this Honorable Court, duly authorized Special Agents of the Intelligence Division, Internal Revenue Service, Treasury Department of the United States, seized a certain 1957 Cadillac "62" Coupe DeVille, License No. MLR 406, Motor No. 5762028343, its tools and appurtenances, from

Charles H. Rutherford, which said automobile had been used unlawfully to further violations of Title 26, [2*] United States Code, Sections 4411 and 4412, as follows: that said automobile had been used by said Charles H. Rutherford in receiving wagers without filing application for a wagering permit, and without payment of wagering occupational tax, with intent to defraud the United States of the said taxes, and in violation of said Sections 4411 and 4412, Title 26, United States Code.

II.

That by reason of these premises the said automobile has become and is subject to seizure for forfeiture pursuant to the provisions of Section 7302, Title 26, United States Code.

III.

That the said 1957 Cadillac "62" Coupe DeVille, License No. MLR 406, Motor No. 5762028343, its tools and appurtenances, has been appraised, as provided by law, in the sum of $4,630.

IV.

That the said Cadillac automobile is presently in the custody of the Intelligence Division, Internal Revenue Service, stored at the General Services Administration Garage, 788 North Main Street, Los Angeles, California, or elsewhere within the jurisdiction of this Court.

*Page numbering appearing at foot of page of original Certified Transcript of Record.

Second Count

I.

That prior to and on or about August 15, 1957, at Compton, County of Los Angeles, within the Central Division of the Southern District of California, and within the jurisdiction of the United States and of this Honorable Court, duly authorized Special Agents of the Intelligence Division, Internal Revenue Service, Treasury Department of the United States, seized a certain 1957 Cadillac "62" Coupe DeVille, License No. MLR 406, Motor No. 5762028343, its tools and appurtenances, from Charles H. Rutherford, which said automobile was intended for use by the said Charles H. Rutherford in receiving wagers without filing application for a wagering permit, [3] and without payment of wagering occupational tax, with intent to defraud the United States of the said taxes, and in violation of said Sections 4411 and 4412, Title 26, United States Code.

II.

Libelant incorporates by reference all the allegations contained in Paragraphs II, III and IV, of the First Count as though herein fully set out.

Wherefore, Libelant prays that the usual process issue against the said automobile, its tools and appurtenances, and that all persons interested in and concerned in the said automobile be cited to appear and show cause why such forfeiture should not be adjudged, and that all due proceedings being had therein, this Honorable Court may be pleased to

condemn the said automobile, its tools and appurtenances, as forfeited to the United States, and that a judgment condemning the said automobile may thereupon be made and entered, and for such other and further judgment and order as to the Court may seem proper in the premises.

LAUGHLIN E. WATERS,
United States Attorney;

RICHARD A. LAVINE,
Asst. U. S. Attorney,
Chief, Civil Division.

/s/ RICHARD A. LAVINE,
Asst. U. S. Attorney,
Attorneys for Libelant.

[Endorsed]: Filed December 16, 1957. [4]

[Title of District Court and Cause.]

MONITION OF RESPONDENT AND CLAIMANT C. H. RUTHERFORD

Comes now C. H. Rutherford, and in answer to the Libel of Information on file herein, admits, denies and alleges as to the First Count:

I.

Admits that on or about August 15, 1957, at Compton, County of Los Angeles, within the Central Division of the Southern District of California, and within the jurisdiction of the United States

and of the above-entitled Court, Special Agents of the Intelligence Division, Internal Revenue Service, Treasury Department of the United States, seized a certain 1957 Cadillac "62" Coupe DeVille, License No. MLR 406, Motor No. 5762028343, its tools and appurtenances, from C. H. Rutherford, this answering respondent, who is the owner thereof; and further admits that this [5] answering respondent did not file an application for a wagering permit and did not pay a wagering occupational tax.

Except as admitted herein, this answering respondent denies generally and specifically each and every other allegation contained in said Paragraph I.

II.

Answering Paragraph II, this answering respondent denies generally and specifically each and every allegation contained in said paragraph.

III.

Answering Paragraph III, this answering respondent alleges that the value of said automobile, its tools and appurtenances, is $5,000.00, which is the reasonable, fair market value thereof.

Except as admitted herein this answering respondent alleges he does not have sufficient information or belief on the subject to answer the remaining allegations of said paragraph, and basing his denial on said lack of information or belief, denies

generally and specifically each and every other allegation contained in said Paragraph III.

IV.

Answering Paragraph IV, this answering respondent alleges that he is informed and believes that the said Cadillac automobile, its tools and appurtenances, are presently in the custody of the Internal Revenue Service, This answering respondent does not have sufficient information or belief on the subject to enable him to answer the remaining allegations of said Paragraph IV, and basing his denial on such lack of information or belief, denies generally and specifically each and every other allegation contained in said Paragraph IV.

And in Answer to the Second Count, this answering respondent admits, denies and alleges: [6]

I.

Answering Paragraph I, admits that on or about August 15, 1957, at Compton, County of Los Angeles, and within the Central Division of the Southern District of California, and within the jurisdiction of the United States and of the above-entitled Court, Special Agents of the Intelligence Division, Internal Revenue Service, Treasury Department of the United States, seized a certain 1957 Cadillac "62" Coupe DeVille, License No. MLR 406, Motor No. 5762028343, its tools and appurtenances, from C. H. Rutherford, this answering respondent, who is the owner of said automobile, tools

and appurtenances; and further admits that he did not file an application for a wagering permit and did not pay a wagering occupational tax.

Except as admitted herein, this answering respondent denies generally and specifically each and every other allegation contained in said Paragraph I.

II.

Answering Paragraph II, this answering respondent incorporates by reference all of the matters contained in Paragraphs II, III and IV of his answer to the First Count as though fully set forth herein.

Wherefore, this answering respondent prays that the libelant take nothing by virtue of its Libel on file herein; that said automobile, its tools and appurtenances be ordered restored to this answering respondent; that this answering respondent recover his costs incurred herein, and for such other and further judgment and order as to the Court may seem proper in the premises.

/s/ MURRAY M. CHOTINER,
Attorney for C. H. Rutherford.

Duly Verified.

Affidavit of Service by Mail attached.

[Endorsed]: Filed January 6, 1958. [7]

[Title of District Court and Cause.]

OBJECTIONS TO FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

Comes now the Libelant, United States of America, and objects to the Claimant's proposed Findings of Fact, Conclusions of Law, and Judgment lodged herein, on the grounds that said Findings of Fact, Conclusions of Law, and Judgment are:

1. Not supported by the evidence introduced at the trial.

2. That the Court has no jurisdiction to award the judgment in the form lodged, i.e. in the alternative, inasmuch as the Claimant's claim was only for the return of the seized property.

The Libelant respectfully requests the Court to set a date on which argument on the within objections may be heard.

LAUGHLIN E. WATERS,
United States Attorney;

RICHARD A. LAVINE,
Asst. U. S. Attorney,
Chief, Civil Division.

/s/ BURTON C. JACOBSON,
Asst. U. S. Attorney.

Affidavit of Service by Mail attached.

[Endorsed]: Filed February 18, 1958. [9]

United States District Court, Southern District of California, Central Division

Civil No. 1392-57—TC

UNITED STATES OF AMERICA,

Libelant,

vs.

ONE 1957 CADILLAC "62" COUPE DE VILLE, License No. MLR 406, Motor No. 5762028343, Its Tools and Appurtenances,

Respondent.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND JUDGMENT

This cause came on regularly for trial on the 14th day of February, 1958, before the Court without a jury, and Laughlin E. Waters, United States Attorney, and Richard A. Lavine and Burton C. Jacobson, Assistant United States Attorneys, by Burton C. Jacobson, appearing as attorneys for libelant, and Murray M. Chotiner for respondent and claimant, Charles H. Rutherford, and from the evidence introduced the Court finds the facts as follows, to wit:

1. That on or about August 15, 1957, at Compton, County of Los Angeles, within the Central Division of the Southern District of California, and within the jurisdiction of the United States and of this Court, duly authorized special agents of the Intelligence Division, Internal Revenue Service, Treasury Department of the United States, seized a cer-

tain 1957 Cadillac "62" Coupe DeVille, License No. MLR 406, Motor No. 5762028343, its tools and appurtenances, from Charles H. Rutherford, who was then and there the owner of said [11] automobile.

2. That said automobile had not been used unlawfully to further violations of Title 26, United States Code, Sections 4411 and 4412.

3. That said automobile had not been used by said Charles H. Rutherford in receiving wagers, nor was it intended for use by Charles H. Rutherford in receiving wagers with intent to defraud the United States of taxes in violation of Sections 4411 and 4412, Title 26, United States Code.

4. That Charles H. Rutherford did not file an application for a wagering permit and did not make payment of a wagering occupational tax as set forth in Sections 4411 and 4412, Title 26, United States Code.

5. That the said automobile did not become, and is not subject to, seizure and forfeiture pursuant to the provisions of Section 7302, Title 26, United States Code.

6. That the said automobile has a value of $4,630.00.

7. That the said automobile has been and is presently in the custody of the Intelligence Division, Internal Revenue Service, within the jurisdiction of this Court.

As a conclusion of law from the foregoing facts, the Court finds that respondent and claimant Charles H. Rutherford is entitled to the return and possession of said automobile, and it is ordered that judgment be entered accordingly.

In accordance with the foregoing Findings of Fact and Conclusions of Law, It Is Ordered, Adjudged and Decreed that the libelant and its special agents of the Intelligence Division, Internal Revenue Service, Treasury Department of the United States, return and deliver possession of said 1957 Cadillac "62" Coupe DeVille, License No. MLR 406, Motor No. 5762028343, its tools and appurtenances, to respondent and claimant Charles H. Rutherford, and in the event a return thereof cannot be had, judgment is given against libelant for $4,630.00, the value of said automobile.

Dated: March 3, 1958.

/s/ THURMOND CLARKE,
United States District Judge.

Affidavit of Service by Mail attached.

Lodged February 17, 1958.

[Endorsed]: Filed and entered March 3, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL TO THE COURT OF APPEALS FOR THE NINTH CIRCUIT

Notice Is Hereby Given that the libelant, United States of America, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this case on March 3, 1958.

Dated: This 7th day of March, 1958.

LAUGHLIN E. WATERS,
United States Attorney;

RICHARD A. LAVINE,
Asst. U. S. Attorney,
Chief, Civil Division.

/s/ BURTON C. JACOBSON,
Asst. U. S. Attorney,
Attorneys for Libelant.

[Endorsed]: Filed March 7, 1958. [14]

In the United States District Court, Southern District of California, Central Division

Civil No. 1392-57—TC

UNITED STATES OF AMERICA,

Libelant,

vs.

ONE 1957 CADILLAC "62" COUPE DE VILLE, License No. MLR 406, Motor No. 5762028343, Its Tools and Appurtenances,

Respondent.

Honorable Thurmond Clarke, Judge Presiding

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Friday, February 14, 1958, 10:00 A.M.

The Court: Do you want to make any opening statement or do you want to call your first witness? I imagine it will be a matter of testimony. Do you want to put a witness right on the stand?

Mr. Jacobson: We have a stipulation, your Honor.

The Court: All right.

Mr. Jacobson: Which I believe will save a great deal of time.

The Court: Certainly.

Mr. Jacobson: That on July 26, 1957, Mr. C. H. Rutherford drove a——

Mr. Chotiner: Say the automobile involved in this litigation.

Mr. Jacobson: No; not in this litigation.

Mr. Chotiner: Pardon me. I am sorry.

Mr. Jacobson (Continuing): ——drove a Ford automobile to a meeting place, the parking lot of Marc's restaurant.

For the Court's information, here is a rough——

(Indicating sketch appearing on blackboard.)

The Court: All right. Bring it around. (Referring to the blackboard containing said sketch.) Right around there.

Mr. Jacobson: ——diagram of the area.

The Court: All right. [3*]

Mr. Jacobson: Marc's is indicated by this red arrow (indicating on blackboard sketch); and met a person by the name of Howard Cupp and a bundle of papers was passed to Mr. Rutherford.

On July 27, 1957, a person by the name of Monica Kissell drove the automobile in question in this case, the 1957 Cadillac, to the parking lot at the same Marc's restaurant and again met Mr. Cupp and a bundle of papers was passed to her.

On July 30th, 1957, Mr. C. H. Rutherford drove the Cadillac in question to the same place and the same thing took place.

On August 5th, Mr. Rutherford drove the Ford that I mentioned before to the same place and the same thing took place.

On the 12th of August, Mr. Rutherford drove the Cadillac to the parking lot of Marc's restaurant and again the same thing took place.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

The same thing also happened on the 13th of August.

And on the 14th of August, Monica Kissell in the Ford went to the same place and the same thing occurred.

And then on August 15th, Mr. Rutherford in the Cadillac met Mr. Cupp at the parking lot of the Marc's restaurant and again the same thing, a bundle of papers was passed to Mr. Rutherford. [4]

Mr. Chotiner: It is stipulated that the Federal Agent, if called to the witness stand, would testify in substance and effect as stated by counsel.

The Court: All right.

Mr. Jacobson: We may further stipulate that the License number of the Cadillac involved is MLR 406.

Mr. Chotiner: It is so stipulated.

The Court: All right.

Mr. Jacobson: And that Mr. C. H. Rutherford, the Claimant in the instant action, is the registered owner of said vehicle.

Mr. Chotiner: It is so stipulated, as well as the legal owner of it.

Mr. Jacobson: Is he the legal owner of it?

Mr. Chotiner: He is now. They have been paid off.

Mr. Jacobson: I will call Mr. Katayama to the stand.

ARTHUR S. KATAYAMA

called as a witness herein on behalf of the Libelant, United States of America, being first duly sworn, testified as follows:

The Clerk: Let me have your name, please?

A. Arthur S. Katayama.

Direct Examination

By Mr. Jacobson:

Q. Mr. Katayama, what is your occupation?

A. I am a Special Agent with the Intelligence Division, [5] United States Treasury Department.

Q. Now, I will direct your attention to August 15th, 1957, and ask you if you had occasion to see Mr. C. H. Rutherford on that date?

A. I did.

Q. I will also ask you if you saw the automobile involved in this litigation on that date, the 1957 Cadillac? A. I did.

Q. Where did you see Mr. Rutherford?

A. I saw him first at approximately 6:20 p.m. on August 15th; he and the car drove up to a position approximately next door north of 110 North Burris Avenue in the City of Compton.

Mr. Jacobson: Can everyone see this board (Indicating sketch on blackboard) all right?

The Court: Yes.

Q. (By Mr. Jacobson): Is this (Indicating sketch on blackboard) the area you are referring to?

A. Yes, this is the area right here (Indicating on said sketch).

(Testimony of Arthur S. Katayama.)

Q. For the record——

A. This is 110 North Burris Avenue (Indicating on said sketch) and this was the automobile. It was parked on the east side of the street, headed north, and it was [6] approximately one door north of the 110 Burris Avenue.

Mr. Jacobson: For the record, may it show that the witness is pointing to a very rough map of the area in question.

The Court: Yes.

Q. (By Mr. Jacobson): Now, where did you see the Cadillac on that date?

A. At this location approximately one door north of 110 North Burris.

Q. And was Mr. Rutherford driving the Cadillac? A. Yes, sir.

Q. And he pulled up where you have that apartment house indicated?

A. Yes; that is correct.

Q. What did you next see Mr. Rutherford do, if anything?

A. He got out of the car, looked around and then entered Apartment F at this address, 110 North Burris avenue.

Q. Did you again see Mr. Rutherford on that date? A. Yes; I did.

Q. Where?

A. In Apartment F at 110 North Burris avenue.

Q. What were the circumstances giving rise to that meeting?

Mr. Chotiner: To which we object, if the court

(Testimony of Arthur S. Katayama.)

please, on the ground that it is incompetent, immaterial and [7] irrelevant as to what occurred or what this Agent found after they got inside the apartment.

The only question involved here is whether or not this automobile was used or intended to be used in the business of receiving wagers on horse races for which there was no stamp or a registration made in accordance with the Act.

And even assuming, for the sake of discussion, that these officers can prove that there was book making being conducted in the apartment, which I am satisfied they can't, or even assuming that they could establish that Mr. Rutherford was engaged in book making in some form or another, they still must prove that this automobile was used or intended to be used for the purpose of engaging in the business of accepting wagers.

Mr. Jacobson: Your Honor, I submit that what took place in the apartment will prove exactly that allegation.

Mr. Chotiner: No matter what took place in the apartment it couldn't prove how the automobile was used. The automobile was never in the apartment.

Mr. Jacobson: Your Honor, I suggest that may the evidence go in subject to a motion to strike, and if it doesn't tie in to the proof of the allegations——

Mr. Chotiner: Then this case may last two or three days if we are going to listen to all this evidence with the idea [8] that it shall be subject to a motion to strike.

(Testimony of Arthur S. Katayama.)

If they have evidence directly pertaining to this automobile, I think they ought to produce that evidence and not go off on a tangent as to what happened in this apartment.

Mr. Jacobson: Your Honor, what took place in the apartment and what was found in the apartment and the conversation with the claimant Mr. Rutherford directly relates to the use of the automobile as alleged by the Government.

The Court: Well, I think the objection of Mr. Chotiner is well taken. I will sustain the objection.

Q. (By Mr. Jacobson): Mr. Katayama, when you saw Mr. Rutherford pull up in the Cadillac in front of that apartment, did he get out of the car?

A. Yes, he did.

Q. Was he carrying anything?

A. Not that I could see.

Q. Did you ever have occasion to talk to Mr. Rutherford on that day? A. I did.

Q. Would you please relate the substance of what that conversation was?

Mr. Chotiner: Objected to on the grounds it is incompetent, immaterial and irrelevant, and on the further [9] ground that no proper foundation has been laid. It is an endeavor to prove an essential element of the Government's case by extra-judicial statements of the claimant.

The Court: I will overrule the objection, providing it relates to the Cadillac car.

Mr. Jacobson: It relates to the Cadillac car.

(Testimony of Arthur S. Katayama.)

The Court: All right. And Mr. Chotiner would like to have a little further foundation.

Q. (By Mr. Jacobson): Did you have any conversation with Mr. Rutherford about the use of this Cadillac automobile? A. Yes, I did.

Q. Did you have any conversation with Mr. Rutherford about the use of the Cadillac automobile regarding any wagering or bookmaking activities?

A. I did.

Mr. Chotiner: I object on the grounds it is leading and suggestive.

The Court: Well, it is, but it brings it right down to date. It is leading, but I will overrule it—He has answered and I will let it remain.

Q. (By Mr. Jacobson): Now, will you please relate that conversation?

Mr. Chotiner: To which we object, if the court please, on the grounds that it is incompetent, immaterial and irrelevant and an endeavor to prove an essential element [10] of the charge contained here by extra-judicial statements without any foundation to show that the automobile was used for that purpose.

The Court: Yes. I sustained the objection just a minute ago and this is the conversation that you are trying to get in that I sustained objection to a minute ago.

Mr. Jacobson: No, your Honor. Mr. Chotiner objected to anything that he may have found inside the apartment or in regard to anything they may have said inside the apartment.

(Testimony of Arthur S. Katayama.)

The Court: This conversation did not take place inside the apartment, then?

Mr. Jacobson: This conversation took place in the apartment. However, the conversation that Mr. Katayama had with a party to this action, I submit, your Honor, is an exception to the hearsay rule, especially if it contains any admissions by the party.

The Court: I will overrule the objection, and let him relate the conversation with Mr. Rutherford.

A. I had in my hand, at the time I was talking to Mr. Rutherford, a piece of paper and I asked him, "Where did you pick up these markers?" And he related to me he picked them up at Marc's parking lot behind Marc's restaurant from a clerk of Swede's, and I asked him how he [11] got down there, and he said by car.

I said, "Did you use your own car?"

He said, "Yes."

I said, "Did you use Kissell's car?" meaning Monica Kissell. And he said, "Yes, I did."

I said, "How long have you been doing this?" And he said, "Ever since Del Mar opened this year."

I further asked him if he was the registered owner of the car, and he stated he was.

That is all of the conversation pertaining to the car.

Q. (By Mr. Jacobson): Now, did you confiscate these pieces of paper that you said to him "Are these your markers?" A. I did.

(Testimony of Arthur S. Katayama.)

Q. When was the last time you saw those papers?

A. I saw them in Judge Westover's court during a criminal proceedings pending against Mr. Rutherford.

Mr. Chotiner: May I interrupt so we can clear up one point right here.

Q. These are papers that were found in the apartment, isn't that correct?

A. That is correct.

Q. (By Mr. Jacobson): Now, I want to just clear up the point as to what you said to him about these papers. I want, to the best of your recollection, the words you used [12] when you referred to these papers and what his answer was to them.

Mr. Chotiner: To which I object, your Honor, on the grounds it has been asked and answered, and apparently it is an attempt on the part of the Government now to impeach his own witness. The Agent has testified.

The Court: I will sustain the objection. He has covered it already.

Q. (By Mr. Jacobson): Now, Mr. Katayama, did you have occasion to check the motor number on the instant car? A. I did.

Q. And what is that motor number?

Mr. Chotiner: Can't we stipulate that the motor number he found was the motor number that was on the Cadillac parked in front of or across the street from 110 Burris avenue, which was the same motor number involved in this litigation?

(Testimony of Arthur S. Katayama.)

Mr. Jacobson: Yes.

A. It was immediately north of 110. It was not across the street.

Mr. Chotiner: Well, parked in Compton.

Mr. Jacobson: No further questions of this witness.

The Court: Mr. Chotiner, do you have any questions?

Mr. Chotiner: I don't think so, but I just want to look at my notes. No questions. [13]

The Court: That is all. You may step down.

Mr. Jacobson: At this time, your Honor, I wish to offer in evidence the record of conviction of Mr. Charles H. Rutherford in case No. 26177-Criminal in the Southern District of California, Central Division, in the United States District Court. My authority for offering the record of this conviction in evidence is the case of United States vs. Wainer, 211 Fed. (2d), 669, a Seventh Circuit case in 1954.

Mr. Chotiner: If the court please, we object to that, first of all on the grounds that there is no final judgment of conviction in that case. The matter is on appeal at the present time by the recommendation of the very Judge who found him guilty, who recommended that an appeal be taken.

The Court: Well, I will overrule your objection, Mr. Chotiner, and let it be made an exhibit. In other words, you have in the record that that matter is now on appeal and there is not a final judgment.

The Clerk: It is Government's Exhibit No. 1 now in evidence.

(Said document was received in evidence and marked as Plaintiff's Exhibit No. One.)

Mr. Jacobson: Next, your Honor, I was planning on calling Mr. Rutherford to the stand as an adverse witness [14] under Rule 43(b). I see that the claimant has chose to remain away from court today.

Mr. Chotiner: I object to that statement of counsel as a conclusion on his part as to what he chose to do or what he did not choose to do. If you wanted the witness here, all you had to do was subpoena him.

The Court: I will let the record remain with counsel's statement that Mr. Rutherford is not available to be called.

Mr. Jacobson: Next, your Honor, I would like to call Mary Smith. She is in the Clerk's office.

Mr. Chotiner: What is it you want?

Mr. Jacobson: I want in evidence what those papers were, when we had them in Judge Westover's court.

The Court: Well, can you send someone after her?

Mr. Chotiner: I think we can save time. I think we can stipulate that they were papers introduced into evidence in the criminal trial which were identified by witnesses for the Government as in their opinion constituting records of the names of horses and the amounts bet on them on races run at race tracks in the United States for the dates in question.

Mr. Jacobson: It is so stipulated.

Mr. Chotiner: And all of them having been found in the apartment, 110 Burris; is that correct? [15]

Mr. Jacobson: That is correct.

The Court: All right. Mary Smith is Judge Westover's clerk.

The Clerk: Yes.

Mr. Jacobson: We would like to call Mr. Marvin H. Ness to the stand.

MARVIN H. NESS

called as a witness herein on behalf of the plaintiff, being first duly sworn, testified as follows:

The Clerk: May we have your name for the record, please?

A. Marvin H. Ness.

Direct Examination

By Mr. Jacobson:

Q. Mr. Ness, what is your business or occupation?

A. I am a Special Agent with the Intelligence Division of the United States Treasury Department.

Q. I will direct your attention to August 15th, 1957, and ask you if you had occasion to see a Mr. Charles H. Rutherford on that date?

A. I did.

Q. What time of day was it when you saw him?

A. About five past six in the evening.

Q. And where was it that you saw him?

(Testimony of Marvin H. Ness.)

A. I saw him in the parking lot behind Marc's restaurant [16] at the intersection of Long Beach boulevard and Myrr Street in Compton.

Q. What did you observe?

A. I observed an individual later identified as Howard Cupp approach Mr. Rutherford in his Cadillac automobile and give to Mr. Rutherford a pack of papers and they had a short conversation for approximately two minutes. Then Mr. Rutherford left the parking lot and I and Special Agent Virgil Crabtree followed Mr. Rutherford down Myrr street west to Burris street and north on Burris street until Mr. Rutherford parked the Cadillac in front of the premises at 110 North Burris street.

Q. Now, on that day did you have a conversation with Mr. Rutherford pertaining to that Cadillac, and pertaining to wagering? A. I did.

Q. Will you please relate to the court what that conversation was?

Mr. Chotiner: Objected to on the grounds it is incompetent, immaterial and irrelevant and that it is being used for the purpose of trying to prove an essential element of the Government's case, a conversation, without the proper foundation first having been established to show a prima facie case.

The Court: I will overrule the objection. He may answer. [17]

A. I asked him if the markers—and I indicated some papers on a coffee table in the apartment at the Burris street location—if the markers were the

(Testimony of Marvin H. Ness.)

ones that he picked up from Cupp behind Marc's that day, and he stated that they were.

Mr. Jacobson: No further questions.

Mr. Chotiner: No questions.

The Court: That is all.

Mr. Jacobson: The Government rests, your Honor.

(Whereupon the plaintiff rested its case.)

Mr. Chotiner: The claimant rests.

(Whereupon the Claimant rested his case.)

The Court: The Government rests and the Claimant rests.

Would you like to make some comments to the court?

Mr. Jacobson: Yes, your Honor, I would like to do that.

The Court: I have your trial brief here.

Mr. Jacobson: I would like to make a brief argument, your Honor.

The Court: All right.

(Argument on behalf of the Plaintiff, by Mr. Jacobson.)

(Argument on behalf of Respondent and Claimant, by Mr. Chotiner.)

(Closing argument on behalf of Plaintiff, by Mr. Jacobson.) [18]

The Court: Well, the court feels differently in this particular case so I will give judgment for the Respondent and Claimant. So that will conclude the

matter. I have read the briefs. The testimony was brief and I see no reason to take the matter under submission. That will be all. The court will be in recess.

I guess Mr. Chotiner will prepare the order.

Mr. Chotiner: Yes.

The Court: He has the winning party so I guess the burden will be upon Mr. Chotiner to prepare the order.

Mr. Chotiner: Thank you, your Honor.

Mr. Jacobson: Will there be Findings, your Honor?

The Court: Do you want Findings?

Mr. Jacobson: Yes, your Honor.

The Court: They will have findings. You will have to prepare Findings.

Mr. Chotiner: Surely.

The Court: All right, [19]

(The court hears other matters.)

The Clerk: Number 8 on the calendar, case No. 1392-57-TC Civil, United States of America vs. One 1957 Cadillac Coupe De Ville.

The Court: Yes. We have the Government's objections here as to the Findings. Does the Government have the car now?

Mr. Jacobson: Yes, your Honor.

The Government's objections are twofold. (1), we object to the findings of fact and conclusions of law as not being supported by the evidence. Secondly, we object to the judgment as proposed in that it is in the alternative for the return of the seized property and secondly for a sum certain of money.

The Court: Well, as to the first point I think Mr. Chotiner's is all right. On the other point I think, Mr. Chotiner, on the money, as long as they have the car, we cannot have any alternative. I think you were just trying to protect yourself on that.

Mr. Chotiner: The reason for that is that I heard through the "grapevine" that the Government is intending to appeal the case, and by the time the matter is finally disposed of I wonder whether the car is going [20] to be worth much.

The Court: Yes, as to the custody of the car. I asked counsel and he said the Government has the car now, Mr. Chotiner.

Mr. Chotiner: In other words, if they are willing to return the automobile, I am perfectly willing that that portion of the judgment be stricken. As a matter of fact, I didn't even know the basis of their objections until this morning. Apparently on their affidavit of mailing, either something went wrong with the United States Attorney's office or the Post Office department forgot to deliver it, but we never received a copy of their objections.

The Court: Well, I will overrule your objections to Mr. Chotiner's. I have gone over that and I feel that Mr. Chotiner's "findings" are all right. But as to this alternative on the car, are you willing to turn the car over or what are you going to do with it?

Mr. Jacobson: Well, your Honor, at this time I don't know. Regarding an appeal, that is strictly up to the Solicitor General.

The Court: That is right.

Mr. Jacobson: What he is going to do I don't know. However, I feel that the court lacks jurisdiction to grant a judgment for money in this type of case.

The Court: Well, I can see—Mr. Chotiner stated he didn't [21] know what they were going to do, and what is your thought on that, Mr. Chotiner? I mean if they take an appeal and it takes a year, you figure that the car won't be worth anything by the time it comes back; you want your judgment?

Mr. Chotiner: That is correct, and I think that under the general prayer here we would be entitled to get it, although I am not in position to represent your Honor this morning as a matter of law that your Honor does have jurisdiction to grant that type of a judgment, but I would say this, that if the matter were signed and that if they were to deliver the automobile, then the Government couldn't possibly be harmed by the alternative provision; whereas, if they intend to appeal anyway, then as long as we are going to have to contest it on appeal, at least we would want to be protected as to the value of the automobile.

The Court: If they knocked out anything, you still would be protected on it.

Mr. Chotiner: That is correct.

Mr. Jacobson: Your Honor, may I suggest this, that if there is error in granting the judgment for the alternative, the case can come back on a remand on that point alone and can be tried over again, on a point that may not be necessary to be decided now.

I would like to cite a case to your Honor on that.

The Court: Certainly. [22]

Mr. Jacobson: It is the Finn case, the Finn Twins, which was a civil action, 239 Federal 2nd, 679, where they were fighting over who had title to the airplane and as part of the defense, it was decided they would put in a counterclaim against the Government for the use of the plane, so to speak, and the Circuit in that case held that there is no Congressional authority for the counterclaim or for the claim to award the money judgment against the Government unless you find an Act of Congress which permits the United States to be sued and a counterclaim and an affirmative judgment of that sort would fall within that category. Then they don't have authority to get such a money judgment against the Government.

And I submit in this situation, on a close reading of the Finn case that I cited, you find the facts are somewhat analogous to the situation here, and you find that in this case there is no Congressional authority for the alternative judgment. It is not within the Torts Claims Act. I don't believe that it falls squarely within the Tucker Act as a claim under ten thousand dollars. If it did, it would be in the nature of an action for the reasonable value of the car today and not for the obtaining of the car.

So I submit, your Honor, that we have no basis for granting the alternative judgment. His prayer asks for the [23] return of the seized property and I suggest that that is the only judgment that can be awarded.

Now, if the Government decides to appeal, it is a right that the Government has and it should not be a factor in determining the type of judgment that the court has jurisdiction to enter.

Mr. Chotiner: Well, does counsel have any case, if I may inquire through the court, on the question of where there is a forfeiture sought by the Government and that the Government is not in a position to return the seized automobile, as to what the remedy is, the fact that we cannot obtain an alternative judgment against the Government?

We are not asking for a money judgment as such.

The Court: I understand.

Mr. Chotiner: It is strictly in the alternative. For example, suppose they had destroyed the automobile, surely we would not be without remedy.

Mr. Jacobson: Perhaps—I would like to point out to your Honor that until very recent years, people injured through the tort of a Government agency were without a remedy, and it is just a question of has the sovereign waived its immunity? If the sovereign hasn't waived its immunity in a situation like this, then you have no remedy.

Mr. Chotiner: Well, I think there has been a waiver where [24] a remedy is given to the Government to seize an automobile and forfeit it under libel proceedings. They take the initiative and then they can't be heard to complain that upon their failure to return the item in accordance with the court order they shouldn't be held responsible for the value of the automobile. It is just in lieu of it, unless there is some authority to the contrary.

The Court: Well, I am going to decide this case, Mr. Chotiner. I don't want you to go all the way up and defend this case on appeal and have it come back just on that question.

Mr. Chotiner. If they were reversed as to that, it would be just a matter of striking that portion, but if the Government is going to appeal anyway, we might just as well defend our position here.

The Court: Yes. Well, I personally don't think that we need to have the money in there about the judgment, but I can see Mr. Chotiner's position. If this matter takes two or three years and the car comes back and the car is practically a wreck, he has nothing. So I will sign it the way Mr. Chotiner has it. In other words, if we get reversed, Mr. Chotiner, we will just have to take that chance.

Mr. Chotiner: Now, I am willing to state here as a matter of record and enter into a stipulation to that effect, that [25] in the event of abandonment of any appeal or if no appeal is taken, I am perfectly willing that the judgment shall be amended to strike that provision for money judgment.

Mr. Jacobson: Well, of course, your Honor, I have no authority whatsoever to enter into such a stipulation.

The Court: We have a little approval as to form here. I don't know as you need to sign that.

Mr. Jacobson: I don't, once your Honor overrules the objections.

The Court: Well, I think we will just go ahead with it, Mr. Chotiner, on that basis. It might take a couple of years and then you wouldn't have anything when it came back.

Mr. Chotiner: That is correct. In other words, we are not after the money. We are after the automobile.

The Court: Yes, and they can solve that by giving you the car right now.

Mr. Chotiner: That is correct. So the Government would not be hurt by giving us the automobile.

The Court: Yes. All right.

Mr. Chotiner: Apparently someone wants to ride around in it. I notice in the file that somebody has already made a request for the automobile. They couldn't even wait to see what your Honor was going to rule.

Mr. Jacobson: As a matter of form, G.S.A. puts in a request for the order and it is a part of the court's file [26] in every case, pending the final outcome.

The Court: I think if the Government is going to take an appeal, what they should do is return the car. It is the fair way to do. Of course that is beyond your power, Mr. Jacobson.

Mr. Jacobson: That is true, your Honor, and here is just a comment on that point: Assuming that the Circuit would reverse on all points, and say that the Government gave the car back in the interim and that Mr. Rutherford sold the car to an innocent third party, who would be injured? The third party?

The Court: Well, I think we are worrying about a lot of things that may never happen.

Mr. Jacobson: That is right, but who knows?

The Court: I think the safe thing to do is to sign the Findings of Fact, Conclusions of Law and Judgment, which I have done at this time.

[Title of District Court and Cause.]

Certificate

I, Thomas B. Goodwill, hereby certify that I am a duly appointed, qualified and acting official court reporter of the United States District Court for the Southern District of California.

I further certify that the foregoing is a true and correct transcript of the proceedings had in the above-entitled matter on February 14, 1958 and March 3, 1958, and that said transcript is a true and correct transcription of my stenographic notes.

Dated at Los Angeles, California, this 11th day of April, A. D. 1958.

/s/ THOMAS B. GOODWILL,
Official Court Reporter.

[Endorsed]: Filed April 14, 1958.

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above-entitled Court hereby certify the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 17, inclusive containing the original:

Libel of Information.

Monition of Respondent and Claimant C. H. Rutherford.

Objections to Findings of Fact, Conclusions of Law and Judgment.

Findings of Fact, Conclusions of Law and Judgment.

Notice of Appeal.

Designation of Record on Appeal.

B. One volume of Reporter's Official Transcript of Proceedings had on:

February 14, 1958 and March 3, 1958.

I further certify that my fee for preparing the foregoing record, amounting to $1.60, has not been paid by appellant.

Dated: April 14, 1958.

[Seal] JOHN A. CHILDRESS,
Clerk,

By /s/ WM. A. WHITE,
Deputy Clerk.

[Endorsed]: No. 15979. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant vs. Charles H. Rutherford, Claimant of One 1957 Cadillac "62" Coupe De Ville, etc., Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: April 15, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

CA No. 15979

UNITED STATES OF AMERICA,

Appellant,

vs.

ONE 1957 CADILLAC "62" COUPE DE VILLE, License No. MLR 406, Motor No. 5762028343, Its Tools and Appurtenances,

Appellee.

STATEMENT OF POINTS ON WHICH APPELLANT INTENDS TO REPLY

The United States of America, Libelant and Appellant in the above-entitled action, states that the points on which it intends to reply on the appeal in this action are as follows:

1. The District Court was without jurisdiction to render the judgment it rendered in the above-entitled proceeding.

2. The Findings of Fact, Conclusions of Law and Judgment are not supported by the evidence.

3. The Judgment is contrary to law.

4. The District Court committed prejudicial error in the admission and rejection of evidence.

Dated: This 18th day of April, 1958.

LAUGHLIN E. WATERS,
United States Attorney;

RICHARD A. LAVINE,
Asst. U. S. Attorney,
Chief, Civil Division.

/s/ BURTON C. JACOBSON,
Asst. U. S. Attorney,
Attorneys for Appellant.

Affidavit of service by mail attached.

[Endorsed]: Filed April 21, 1958.

No. 15981

United States
Court of Appeals
for the Ninth Circuit

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California Southern Division.

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-13-58

No. 15981

United States Court of Appeals

for the Ninth Circuit

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California Southern Division.

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-13-58

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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Los Angeles 12, California.

United States District Court, Southern District of California, Southern Division

No. 1661-Civ. SD

WATER F. FREEMAN,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT TO RECOVER INCOME TAXES PAID AND FOR INCOME TAX EXEMPTION ON UNITED STATES NAVY RETIRED PAY

The above-named plaintiff, in propria personna, complains of the defendant and alleges:

I.

The Income Tax Return for the period here involved was filed with the Director of Internal Revenue for the District of Los Angeles, California.

II.

Plaintiff is a citizen of the United States and resides in the City of San Diego, County of San Diego, State of California.

III.

On or about March 15, 1953, plaintiff duly and regularly filed his income tax return for the year

1952, in which he reported that $22.10 for the month of January, 1952, had been withheld from U. S. Navy retired pay and enclosed a voucher showing that deductions for the balance of the year had been discontinued by the Chief of the Bureau of Supplies and Accounts, Field Branch, Navy Department, [2*] Cleveland, Ohio, in the belief that plaintiff was entitled to income tax exemption on his retired pay.

IV.

Plaintiff duly and regularly filed with defendant on Form 843 a claim for refund of the sum of $22.10 withheld from his retired pay as aforesaid on the following grounds:

V.

That he was transferred to the Fleet Naval Reserve on June 25, 1939, for reasons other than physical disability; recalled to active duty on September 11, 1939; and retired for physical disability on February 18, 1943 (in time of war).

VI.

That Section 402(a) of the Career Compensation Act (63 Stat. 802, 817, lines 9-12) states:

"That any disability shown to have been incurred in line of duty during a period of active service in time of war or national emergency shall be considered to be the proximate result of the performance of active duty."

*Page numbering appearing at foot of page of original Certified Transcript of Record.

VII.

That the Bureau of Medicine & Surgery, Navy Department, Washington, D. C., stated in its letter to plaintiff of July 15, 1947:

"Your medical record on file in the Bureau of Medicine & Surgery shows that you were placed on the retired list on March 1, 1943, by reason of physical disability incurred in line of duty."

VIII.

That prior to the enactment of the Career Compensation Act of October 12, 1949 (63 Stat. 802), plaintiff's retired pay was exempt from taxation and his income tax returns were audited and approved by the Director of Internal Revenue, Los Angeles, California.

IX.

That upon the enactment of the Career Compensation Act, plaintiff received from Chief of Field Branch, Bureau of Supplies [3] & Accounts, Navy Department, Cleveland, Ohio, an Income Tax Information Bulletin and selection blanks.

X.

That on February 23, 1951, plaintiff filled out section blanks and elected to have his retired pay computed in accordance with Method B (based on the provisions of the Career Compensation Act).

XI.

That on June 19, 1951, plaintiff filled out superseding selection blanks and elected to have his re-

tired pay computed in accordance with Method C (based on laws in effect prior to the enactment of the Career Compensation Act, and restoring him to his former status).

XII.

That the Chief of Field Branch, Bureau of Supplies & Accounts, Navy Department, Cleveland, Ohio, thereupon issued plaintiff a copy of his letter dated January 18, 1952, addressed to the Commissioner of Internal Revenue, Washington, D. C., which read in part as follows:

"Under the authority of the Commissioner of Internal Revenue's letter of August 20, 1943, addressed to the Paymaster General of the Navy, IT:P:T-2:AOM-2, withholding in this case has been suspended and this suspension will continue until a specific ruling from the Revenue authorities advising otherwise is received."

XIII.

That a copy of this letter accompained plaintiff's income tax returns for the year, 1952, as a voucher for exemption.

XIV.

That the Director of Internal Revenue, Los Angeles, California, stated in his letter to plaintiff of September 11, 1953:

"If you wish that further consideration be given your case, please forward the following information:

"Copies of official notifications as to percentage of [4] disability and election available to you under the Career Compensation Act of 1949, and copies of the election (or elections) made."

XV.

That the Director of Internal Revenue, Los Angeles, California, stated in his letter to plaintiff of September 21, 1953:

"Under the above circumstances, the retirement pay would not qualify for exemption under the laws in effect either prior to or subsequent to the enactment of the Career Compensation Act, regardless of the election which was made at that time."

XVI.

That the Chief of Field Branch, Bureau of Supplies & Accounts, Navy Department, Cleveland, Ohio, stated in its Income Tax Information Bulletin:

"Certain items of income are specifically excluded from gross income and are not, therefore, to be shown on the return. The following items fall into this category:

"a. Retired pay of persons retired from the naval service prior to 1 October, 1949, for physical disability resulting from active service. This includes the retired pay of persons recalled to active duty subsequent to retirement for other than physical disability and returned to inactive duty prior to 1 October, 1949, under Section 8(b) or (d)

of the Temporary Promotion Law of July 24, 1941 (Public Law 188, 77th Congress) after incurring physical disability while on such active duty."

XVII.

That Section 8(b) of said Temporary Promotion Law (55 Stat. 603, 604, lines 36-42) states:

"An officer or enlisted man of the retired list of the regular Navy or Marine Corps who was placed thereon for reasons other than physical disability shall, if he incurs physical disability while serving under a temporary appointment in higher rank, be advanced on the retired list to such higher rank with retired pay at the rate [5] of 75 per centum of the active duty pay to which he was entitled while serving in that rank."

XVIII.

That the legislators were fully aware that the personnel who had been retired were retired for length of service by the incorporation of the phrase in the legislation, "who were placed thereon for reasons other than physical disability."

XIX.

That the intent of the legislation appears to be to provide a convenient means of redeeming compensation for those who were physically disabled under the stress of war duty, as Section 8(e) of said Temporary Promotion Law (55 Stat. 603, 604, lines 56-58) states:

"The benefits of this section shall apply only to an individual who incurs physical disability in line of duty in time of war or national emergency."

XX.

That plaintiff was legally entitled to change his selection from Method B to Method C, as Section 511 of the Career Compensation Act (63 Stat. 802, 829, lines 1-12) states:

"On and after the effective date of this Section (1) members of the uniformed services heretofore retired for reasons other than for physical disability * * * shall be entitled to receive retired pay, retirement pay, retainer pay, or equivalent pay, in the amount whichever is greater, computed by one of the following methods: (a) The monthly retired pay, retainer pay, or equivalent pay in the amount authorized for such members and former members by provisions of law in effect on the day immediately preceding the date of the enactment of this act * * *"

XXI.

That Section 402(h) of the Career Compensation Act (63 Stat. 802, 820, lines 29-36) states:

"That part of the disability retirement pay computed on the basis of years of active service which is in excess of the [6] disability retirement pay that a member would receive if such disability pay were computed on the basis of percentage of disability shall not be deemed to be a pension, annuity, or similar allowance for personal injuries or sick-

ness resulting from active service in the armed forces of any country within the meaning of Section 22(b)(5) of the Internal Revenue Code as amended."

XXII.

That this section would apply if retired pay were computed under the provisions of the Career Compensation Act, but not if computed under laws in effect prior to the enactment of this act.

XXIII.

That the decision of the Director of Internal Revenue, Los Angeles, California, is based on misinterpretations of the law in the following particulars:

That the Internal Revenue Agent at San Diego (Mr. Poole, initials unknown) stated that plaintiff signed Selection B, electing to have his retired pay computed under the provisions of the Career Compensation Act and that was final and conclusive and he did not have a leg to stand on.

That the Director of Internal Revenue, Los Angeles, California, in his letter to plaintiff of September 21, 1953, stated:

"On June 26, 1939, you were transferred to the Fleet Reserve by reason of length of service. No mention was made in the Orders of any physical disability.

"It appears that upon your release from active duty, you merely resumed the retired status that

you held prior to being recalled to active duty, which was based on years of service. There is no evidence that your retired status had been changed or that there was any change in the purpose for which the Navy Department paid the retirement benefits.

"The correspondence indicates that the Evaluation Board determined that the percentage of your disability was 'zero' at the time of your retirement. This appears to mean that the nature of [7] the disability was of the nonratable type, not having been due to any injury or sickness resulting from active service."

XXIV.

That the Director of Internal Revenue, Los Angeles, California, advised plaintiff that his claim for refund had been disallowed, in his letter of April 12, 1954, in which was enclosed a copy of Form 885-D titled "No Change Report of Income Tax Audit for the year ended December 31, 1952."

XXV.

That plaintiff received by registered mail from the Director of Internal Revenue, Los Angeles, California, notice of disallowance in full of his claim, in accordance with section 3772(a)(2) of the Internal Revenue Code.

XXVI.

Wherefore, plaintiff prays for a judgment against the defendant upon the facts and law for

the principal sum of $22.10 and for income tax exemption on his U. S. Navy retired pay.

/s/ WALTER F. FREEMAN.

Duly verified.

[Endorsed]: Filed October 11, 1954.

[Title of District Court and Cause.]

ANSWER AND COUNTERCLAIM

The defendant, by its attorney, Laughlin E. Waters, United States Attorney for the Southern District of California, answers the allegations in plaintiff's complaint and counterclaims against the plaintiff as follows:

First

Denies the allegations of such complaint not admitted, qualified or otherwise specifically referred to below;

Second

1. Admits the allegations in paragraph I.

2. Admits the allegations in paragraph II.

3. Denies the allegations in paragraph III, except that it is admitted that on or about March 15, 1953, plaintiff filed his income tax return for 1952 in which he reported income of $2,064.56 and tax withheld of $22.10.

4. Denies the allegations in paragraph IV, except that it is admitted that plaintiff filed a claim

for refund on Form 843 in the amount of [10] $22.10.

5. Denies the allegations in paragraph V for lack of knowledge or information sufficient to form a belief.

6. States that no responsive pleading is required to paragraph VI and the citation of law therein.

7. Denies the allegations in paragraph VII.

8. Denies the allegations in paragraph VIII.

9. Denies the allegations in paragraph IX for lack of knowledge or information sufficient to form a belief.

10. Denies the allegations in paragraph X for lack of knowledge or information sufficient to form a belief.

11. Denies the allegations in paragraph XI.

12. Denies the allegations in paragraph XII.

13. Denies the allegations in paragraph XIII.

14. Admits that the quoted matter in paragraph XIV is a portion of but not the entire statement of the Director in said letter.

15. Denies the allegations in paragraph XV, except that Exhibit A attached hereto is a true copy of the letter dated September 21, 1953, from the District Director of Internal Revenue to plaintiff.

16. Denies the allegations in paragraph XVI for lack of knowledge or information sufficient to form a belief.

17. States that no responsive pleading is required to paragraph XVII and the citation of law therein.

18. Denies the allegations in paragraph XVIII.

19. Denies the allegations in paragraph XIX.

20. States that paragraph XX does not contain allegations of fact to which a response can be made, but that if a response thereto is required, the allegations of such paragraph are denied.

21. States that no responsive pleading is required to paragraph XXI and the citation of law therein.

22. States that paragraph XXII does not contain allegations of fact [11] to which a response can be made, but that if a response thereto is required, the allegations of such paragraph are denied.

23. Denies the allegations in paragraph XXIII, except that Exhibit A attached hereto is a true copy of the letter dated September 21, 1953, from the District Director of Internal Revenue to plaintiff.

24. Admits the allegations in paragraph XXIV except that it is denied that the Director advised plaintiff in his letter of April 12, 1954, that his refund claim had been disallowed.

25. Denies the allegations in paragraph XXV.

26. Denies the allegations in paragraph XXVI.

Wherefore, the United States, having fully answered plaintiff's complaint, prays that plaintiff take nothing in this action, that his complaint be dismissed and that the United States be allowed its costs.

Third

For counterclaim against the plaintiff the United States alleges as follows:

1. Defendant, United States of America, files this counterclaim under the direction of the Attorney General of the United States and with the authorization of the Commissioner of Internal Revenue of the United States Treasury Department.

2. On or about March 22, 1953, the Commissioner of Internal Revenue duly assessed against plaintiff income tax for the year 1952 in the amount of $279.

3. Notice was duly given and demand was duly made for payment of said assessment. Said assessment has not been paid, with the exception of $22.10 and there remains due and owing to the United States the sum of $256.90 plus interest. [12]

Wherefore, the Defendant, United States of America, demands judgment against plaintiff for

the amount of $256.90 with interest and costs as allowed by law.

LAUGHLIN E. WATERS,
United States Attorney;

EDWARD R. McHALE,
Assistant United States Attorney, Chief, Tax Division;

BRUCE I. HOCHMAN,
Assistant United States Attorney,

/s/ EDWARD R. McHALE,
Attorneys for Defendant.

EXHIBIT A

Los Angeles 12, California

September 21, 1953.

A:O:DH.
Room 747 Federal Bldg.

Mr. Walter F. Freeman,
500 West Broadway,
San Diego 1, California.

Dear Mr. Freeman:

Further reference is made to your request for a determination as to the status of your Naval retirement pay. The entire case has been carefully reviewed, and it is still the opinion of this office

that your retirement pay does not qualify for exemption under the provisions of section 22(b)(5) of the Internal Revenue Code.

In order that the retirement pay may be exempt from tax, it would have to come within the provisions of section 22(b)(5) of the Code, which provides in part that amounts received as a pension or similar allowance for personal injuries or sickness resulting from active service in the armed forces shall be exempt from tax.

The correspondence indicates that you believe that if you had made an election under the Career Compensation Act of 1949 to receive retired pay based on the laws in effect prior to the effective date of that act, you would be exempt from the tax. The records which you submitted disclose the following:

> On June 26, 1939, you were transferred to the Fleet Reserve by reason of length of service. No mention was made in the Orders of any physical disability.
>
> Under Orders of September 11, 1939, you were recalled to active duty.
>
> On February 18, 1943, you received Orders releasing you from active duty, which the recommendation that you be placed on the retired list as you were "found not physical qualified to perform the duties of your rating at sea."

It appears that upon your release from active duty, you merely resumed the retired status that

you held prior to being recalled to active duty, which was based on years of service. There is no evidence that your retired status had been changed or that there was any change in the purpose for which the Navy Department paid the retirement benefits.

The Career Compensation Act of 1949 authorized the study of military personnel retired with physical disabilities,

> (1) To ascertain whether the disability had its inception during a period of active service in the armed forces; and, if so
>
> (2) To rate the disability under the same percentage factor used by the Veterans Administration.

The correspondence indicates that the Evaluation Board determined that the percentage of your disability was "zero" at the time of your retirement. This appears to mean that the nature of the disability was of the nonratable type, not having been due to any injury or sickness resulting from active service. This is further confirmed by letter of January 18, 1953, from the Department of the Navy which states in part that according to the records available in that office, you were "not retired for a physical disability incurred in active service."

Under the above circumstances, the retirement pay would not qualify for exemption under the laws in effect either prior to or subsequent to the enact-

ment of the Career Compensation Act, regardless of the election which was made at that time.

Very truly yours,

R. A. RIDDELL,
District Director.

Affidavit of Service by Mail attached.

[Endorsed]: Filed January 26, 1955.

[Title of District Court and Cause.]

ANSWER TO COUNTERCLAIM

The plaintiff, in pro. per., answers the counterclaim, being the Third Section of defendant's answer, as follows:

1. Denies the allegations in paragraph 1 for lack of knowledge or information sufficient to form a belief.

2. Admits the allegation in paragraph 2.

3. Admits the allegations in paragraph 3 except that it is denied that there remains due and owing to the United States the sum of $256.90 plus interest, if plaintiff's claim is allowed.

Wherefore, plaintiff will, if claim for exemption is disallowed, honor the demand for $256.90 plus interest forthwith; but, if claim for exemption is allowed. prays that defendant take nothing for his counterclaim.

Dated: February 14, 1955.

/s/ WALTER F. FREEMAN,
In Pro. Per.

Affidavit of service by mail attached.

[Endorsed]: Filed February 14, 1955. [16]

[Title of District Court and Cause.]

SUBSTITIUTION OF ATTORNEYS

Plaintiff hereby substitutes Philip Crittenden as his attorney of record in place of Walter F. Freeman, in Pro. Per.

Dated: May 24, 1955.

/s/ WALTER F. FREEMAN

I consent to the above substitution.

Dated: May 24, 1955.

/s/ WALTER F. FREEMAN.

Above substitution accepted.

Dated: May 24, 1955.

/s/ PHILIP CRITTENDEN.

[Endorsed]: Filed May 25, 1955. [18]

[Title of District Court and Cause.]

PRETRIAL STIPULATION AND ORDER

Section I—Admitted Facts

The facts are agreed upon by the parties, as follows:

1. Plaintiff filed his income tax return for the year 1952 on or before March 15, 1953, in which he reported income of $2,064.56 and income tax withheld of $22.10;

2. Plaintiff filed a Claim for Refund on the proper form furnished by the Department of Internal Revenue and within the time provided by law; said claim for refund was denied on May 24, 1954; said claim was based on the contention of plaintiff that the Retirement Pay received by plaintiff from the U. S. Navy was exempt from taxation as being retirement pay paid to a retired navy enlisted man who was retired for physical disability resulting from active service in the U. S. Navy.

3. That plaintiff received retirement pay from the U. S. Navy during the year 1952 in the sum of $2,064.56.

4. That the sum of $22.10 was withheld from plaintiff by the U. S. Navy as Income Tax Withheld; that if said retirement pay is taxable income, plaintiff [29] owes the sum of $256.90 as Income Tax for the year 1952.

5. That plaintiff was an enlisted man in the U. S. Navy continuously from May 6, 1918, to June 26, 1939; that on June 26, 1939, plaintiff was transferred to the Fleet Reserve based on length of service.

6. That on September 11, 1939, plaintiff was recalled to active duty at Headquarters, 11th Naval District, San Diego, California; that at the time of his recall to active duty, plaintiff was given a physical examination and found to be physically fit for all duty.

7. That plaintiff was continuously on active duty from September 11, 1939, to February 18, 1943, during which entire time he was stationed on shore duty in the San Diego area. On February 18, 1943, he was released from active duty as the result of a physical examination; that said physical examination which was made on January 5, 1943, found that plaintiff had the following defects:

(1) Arteriosclerosis, general #210

(2) Vision 10/20 left, 16/20 right, corrected to 20/20 in each eye by glasses.

(3) Varicose veins, legs and feet #249;

that said physical examination recommended that plaintiff was "not fit to perform active duty at sea or on foreign service" and "not physically qualified for any duty"; that such recommendation was approved by the Chief of the Bureau of Medicine and Surgery on the 21st day of January, 1943, and it was further recommended that plaintiff be re-

leased from active duty and placed on the retired list.

8. That by letter order dated the 6th day of February, 1943, the Chief of Naval Personnel directed that in accordance with the recommendation of the Chief of the Bureau of Medicine and Surgery dated January 21, 1943, plaintiff be released from active duty and placed on the Retired List on the 1st day of the month following his release from active duty under the authority of the Naval Reserve Act of 1938.

9. That in accordance with said letter order, plaintiff was released from active duty on the 18th day of February, 1943, and placed on the retired list as of the 1st day of March, 1943. [30]

10. That, after the adoption of the 1949 Career Compensations Act, the Physical Review Council of the Bureau of Personnel assigned to plaintiff a Percentage of Disability of Zero (00) and requested plaintiff to elect one of the three options available.

11. That, in accordance with said request, plaintiff first elected Option "B" which computed compensation based on the new compensation established by the 1949 Career Compensations Act; that, subsequently, plaintiff changed said election to elect Option "C" which computed compensation based on the laws in effect prior to the 1st day of October, 1949, the effective date of the 1949 Career Compensation Act; that, as a result of said corrected election, all retirement pay received by plaintiff

since the 1st day of October, 1949, has been based on the laws in effect prior to the 1st day of October, 1949, the effective date of the 1949 Career Compensation Act.

12. That on or about the 14th day of February, 1956, plaintiff filed an application with the Board for Correction of Naval Records, Department of the Navy, for the purpose of having the Percentage of Disability assigned to plaintiff by the Bureau of Personnel corrected; that by letter dated the 14th day of August, 1956, the Board for Correction of Naval Records denied a hearing on such application of plaintiff on the basis that the disability rating of 0% assigned by the Physical Review Council was correct and proper and that plaintiff's medical records do not indicate that plaintiff was suffering from a disability ratable under the Schedule for Rating Disabilities in current use by the Veterans Administration at the time of plaintiff's retirement on the 1st day of March, 1943.

13. That plaintiff's retirement pay is based on over 24 years of service, that no portion of which pay is computed on the basis of a disability factor.

14. That plaintiff's retirement pay since the 1st day of October, 1949, has been based on the laws in effect prior to the 1949 Career Compensations Act under the provision of said Act which permits retired personnel to so elect.

15. That plaintiff's retirement pay is exempt from income tax if said retirement pay is received

"for personal injuries or sickness resulting from active service in the armed forces of any country" under Section 22 (b) (5) of the [31] Internal Revenue Code, as amended by section 113 of the Revenue Act of 1942; that if plaintiff's retirement pay does not qualify under said section 22 (b) (5) of the Internal Revenue Code, as amended, said retirement pay is taxable income to plaintiff.

16. That plaintiff has exhausted his administrative remedies with the Department of the Navy; that plaintiff has exhausted his administrative remedies with the Treasury Department prior to filing this action.

Section II—Issues

Issue of Law:

1. Is plaintiff's retirement income for the year 1952 taxable under the Federal Income Tax laws?

Section III—Documentary Evidence

It is stipulated between the parties hereto that the following documents may be admitted into evidence:

Plaintiff's Exhibits:

1. Medical record of plaintiff.

2. Copy of orders dated 6 February, 1943, directing placement of plaintiff on the Retired List of the Navy.

3. Letter from Board for Correction of Naval Records dated 14 August, 1956, with copy of opinion of the Chief, Bureau of Medicine and Surgery, dated 24 July, 1956, attached.

4. Copy of election made February 23, 1951, electing Method B.

5. Copy of election made June 19, 1951, electing Method C.

6. Payroll Computing Form dated the 30th day of December, 1955, showing adjustment of pay retroactive to October 1, 1949, to reduce pay to that entitled under Election C.

7. Orders transferring plaintiff to Fleet Reserve dated 26 June, 1939.

8. Orders recalling plaintiff to active duty dated 11 September, 1939. [32]

9. Copy of orders dated February 18, 1943, releasing plaintiff from active duty.

10. Copy of orders dated March 1, 1943, placing plaintiff on Retired List.

11. Plaintiff's service record.

12. Plaintiff's 1952 Income Tax Return.

/s/ PHILIP CRITTENDEN,
Attorney for Plaintiff.
LAUGHLIN E. WATERS,
United States Attorney;

By /s/ REMBERT T. BROWN,
Attorney for Defendant.

Dated: November 8, 1956.

It Is So Ordered:

/s/ JACOB WEINBERGER.

[Endorsed]: Filed November 8, 1956. [33]

PLAINTIFF'S EXHIBIT No. 2

Pers-663-HVP
MM 151 61 65

February 6, 1943.

From: The Chief of Naval Personnel.
To: The Medical Officer in Command, Naval Hospital, San Diego, Calif.

Subject: Freeman, Walter Frederick, CY(PA), F-4-D, USNR—Placing on the Retired List of the Navy.

References:

(a) Report of physical examination January 5, 1943.

(b) Bureau of Medicine and Surgery's recommendation dated January 21, 1943.

(c) Naval Reserve Act of 1938.

(d) U.S.N. Travel Instructions, Article 2503(12).

1. In accordance with reference (b), which is approved, it is directed that the subject man be

placed on the Retired List of the Navy by the authority contained in reference (c).

2. This man should be ordered to his home and consider himself released from active duty upon arrival. Place him on the Retired List on the first day of the month following release to inactive duty. Furnish the Field Branch, Bureau of Supplies and Accounts (Master Accounts Division), Navy Department, Cleveland, Ohio, four (4) certified copies of your letter directing retirement.

3. Original of page 9, showing dates of release and retirement, reason for such action and present home address, should be placed in service record and duplicate forwarded to this Bureau.

4. He is Not physically qualified for mobilization ashore.

RANDALL JACOBS,
The Chief of Naval Personnel.

H. L. NAFF,
By Direction.

Certified by:

/s/ J. L. HOLLOWAY, JR.,
Vice Admiral, USN, Chief of
Naval Personnel.

[Endorsed]: Filed November 2, 1956.

PLAINTIFF'S EXHIBIT No. 3

Department of the Navy
Board for Correction of Naval Records
Washington 25, D. C.

SMF:frs
14 August, 1956.

Mr. Walter Frederick Freeman,
c/o Philip Crittenden, Esq.,
602 Scripps Building,
San Diego 1, California.

My Dear Mr. Freeman:

Reference is made to your application for correction of your naval record, under the provisions of Section 207 of the Legislative Reorganization Act of 1946, as amended (65 Stat. 655).

Administrative regulations and procedures established by the Secretary of the Navy for the guidance of this Board provide that the burden of proof is on a Petitioner to show by documentary evidence that an error has been made, or an injustice has been suffered. Further, a hearing by the Board may be denied when a Petitioner has failed to show that an entry or omission in his naval record was improper or unjust under then existing standards of naval law, administration, and practice.

In view of the fact that your application presented disputed questions of medical fact the records in your case were referred to the Chief, Bu-

reau of Medicine and Surgery for an advisory opinion. A copy of the opinion of the Chief, Bureau of Medicine and Surgery dated 24 July, 1956, is enclosed for your information.

Preliminary examination of your naval record and review of the material submitted by you fails to establish a sufficient basis for further action by this Board.

It is not the intention of the Board to imply that a subsequent review of your case may not be had. As stated above, however, the burden is on you to show that an error or injustice has occurred.

In the absence of additional material evidence, no further action on your application is contemplated.

Sincerely yours,

/s/ F. W. BREW,
Assistant Executive Secretary, by Direction of the Chairman.

Encl:
Chief, BuMed ltr dated 24 July, 1956.

Copy to:
Mr. Philip Crittenden,
Attorney at Law.

BUMED-3
Freeman, Walter Frederick
151 61 65

24 July, 1956.

First Endorsement on BCNR ltr SMF:hkh dated 16 May, 1956.

From: Chief, Bureau of Medicine and Surgery.
To: Chairman, Board for Correction of Naval Records.

Subj: Walter Frederick Freeman, 151 61 65, YNSC, USN (Retired); Advisory opinion in the case of.

1. Returned.

2. A review of petitioner's records reveals that he was transferred to the Fleet Reserve and released from active duty on 26 June, 1939. He was recalled to active duty on 11 September, 1939, released from active duty on 18 February, 1943, and placed on the retired list by reason of physical disability on 1 March, 1943.

3. Petitioner's medical records reveal that he was found not physically qualified for any duty as the result of a physical examination conducted on 5 January, 1943. The report of the physical examination listed petitioner's physical defects as general arteriosclerosis, defective vision and varicose veins of the legs and feet. The Bureau of Medicine and Surgery concurred in the findings of the medical examiners and recommended that petitioner be released from active duty and placed on the retired list.

4. On 16 October, 1950, the Physical Review Council assigned petitioner a disability rating of 0% under the provisions of Section 411 of the Career Compensation Act of 1949.

5. A review of petitioner's medical records reveals that prior to his retirement on 1 March, 1943, there was no evidence of renal, cardiac, or cerebral complications as the result of his generalized arteriosclerosis. There was, however, evidence of generalized arteriosclerosis in the lower extremities. The symptoms and physical findings were not of such character as to be ratable under the Schedule for Rating Disabilities in current use by the Veterans Administration. Petitioner's defective vision was slight and was correctable to 20/20. Petitioner presented mild asymptomatic varicosities of the superficial veins of the lower legs and feet.

6. From a review of petitioner's medical records it is the opinion of this Bureau that the disability rating of 0% assigned by the Physical Review Council was correct and proper and that petitioner's medical records do not indicate that he was suffering from a disability ratable under the Schedule for Rating Disabilities in current use by the Veterans Administration at the time of his retirement on 1 March, 1943.

I. L. V. NORMAN,
Assistant Chief for Personnel and Professional Operations.

[Endorsed]: Filed November 2, 1956.

PLAINTIFF'S EXHIBIT No. 4

F-129

Department of the Navy
Bureau of Naval Personnel
Washington 25, D. C.

In Reply Refer to:
Pers-E354-JDB:js
151 61 65

6 Dec., 1950.

From: Chief of Naval Personnel.

To: Walter Frederick Freeman, 151 61 65, YNC, USN (Ret.).

Via: Chief, Field Branch, Bureau of Supplies and Accounts, Cleveland 14, Ohio.

Subj: Election as to Retirement Pay Benefits under the Provisions of the Career Compensation Act of 1949 (Public Law 351-81st Congress).

Ref:

(a) Subject Law.

Encl:

(1) Excerpts from subject law: Sec. 402 (d), Sec. 402 (h) and Sec. 411.

(2) Information Bulletin.

1. In accordance with Section 411 of reference (a) and pursuant to regulations prescribed by the President of the United States, the Secretary of the Navy has determined your percentage of disability. This determination and other applicable factors of service credit are as follows:

Percentage of Disability: Zero (00).

Years of Active Service: Twenty-four (24).

Highest Rating satisfactorily held for retirement pay purposes: Chief Yeoman.

1. Exact gross payment information applicable in accordance with reference (a) and the above factors will be endorsed hereon by the disbursing officer having custody of your retired pay record.

/s/ H. C. BERNET,
By Direction.

List No. FR3.

XRA:LW:zd
151 61 65

First Endorsement on BuPers ltr Pers-E354-JDB: js of 6 Dec., 1950.

1. In accordance with reference (a) of basic letter you are entitled to receive retired pay computed, At Your Election, by one of the following methods:

*Method A: Monthly basic pay of $..... for ..... with over .... years service for basic pay purposes multiplied by ....% (disability) which would amount to $..... monthly gross retired pay. (Not to exceed 75%.)

Method B: Monthly basic pay of $279.30 for YNC with over 22 years service for basic pay purposes

*Since percentage of disability is zero% you are not entitled to this method of computation.

multiplied by 60% (2½ x years active service) which would amount to $167.58 monthly gross retired pay. (Not to exceed 75%.)

Method C: Monthly gross retired pay of $163.35 based on laws in effect prior to 1 October, 1949.

2. Your account was mechanically adjusted to $167.58 under Method "B" effective 1 October, 1949. If you desire to continue to receive this amount each month, you should elect Method "B." Unless your election is made and returned to this office within sixty days, your monthly gross pay will revert to $163.35 (Method "C") and checkage for the difference between Methods "B" and "C" retroactive to 1 October, 1949, will be entered against your account and liquidated at the rate of one-half your gross pay each month until the difference has been cleared.

3. Indicate your election in the space below. Sign three copies of the election form and return them in the enclosed postage free envelope.

/s/ J. B. WARNER,
By Direction, Chief, Field Branch, Bureau of Supplies and Accounts, Cleveland 14, Ohio.

Date: February 23, 1951.

From: Freeman, Walter Frederick, 151-61-65, YNC, USN, Retired.
To: Secretary of the Navy.
Via: Chief, Field Branch.

Subj: Election of pay under Public Law 351-81st Congress.

1. I elect to receive retired pay in accordance with Method B under which I understand my gross pay will be $167.58.

2. I understand that this election, once made, is final and conclusive for all purposes.

/s/ WALTER FREDERICK FREEMAN,
500 West Broadway.

(Rank or Rating): YNC.

(Service Number): 151-61-65.

City: San Diego.

(State): California.

*For your records.

Enl Ret 1

[Endorsed]: Filed November 2, 1956.

PLAINTIFF'S EXHIBIT No. 5

(Duplicate)

XRA:LW:zd
151 61 65

First Endorsement on BuPers ltr Pers-E354-JDB: js of 6 Dec., 1950.

1. In accordance with reference (a) of basic letter you are entitled to receive retired pay com-

puted, At Your Election, by one of the following methods:

*Method A: Monthly basic pay of $..... for ..... with over .... years service for basic pay purposes multiplied by ....% (disability) which would amount to $..... monthly gross retired pay. (Not to exceed 75%.)

Method B: Monthly basic pay of $279.30 for YNC with over 22 years service for basic pay purposes multiplied by 60% (2½ x years active service) which would amount to $167.58 monthly gross retired pay. (Not to exceed 75%.)

Method C: Monthly gross retired pay of $163.35 based on laws in effect prior to 1 October, 1949.

2. Your account was mechanically adjusted to $167.58 under Method "B" effective 1 October, 1949. If you desire to continue to receive this amount each month, you should elect Method "B." Unless your election is made and returned to this office within sixty days, your monthly gross pay will revert to $163.35 (Method "C") and checkage for the difference between Methods "B" and "C" retroactive to 1 October, 1949, will be entered against your account and liquidated at the rate of one-half your gross pay each month until the difference has been cleared.

---

*Since percentage of disability is zero% you are not entitled to this method of computation.

3. Indicate your election in the space below. Sign three copies of the election form and return them in the enclosed postage free envelope.

/s/ J. B. WARNER,
By Direction, Chief, Field Branch, Bureau of Supplies and Accounts, Cleveland 14, Ohio.

Date: June 19, 1951.

From: Freeman, Walter Frederick, 151-61-65, YNC, USN, Retired.
To: Secretary of the Navy.
Via: Chief, Field Branch.

Subj: Election of pay under Public Law 351-81st Congress.

1. I elect to receive retired pay in accordance with Method C under which I understand my gross pay will be $163.35.

2. I understand that this election, once made, is final and conclusive for all purposes.

/s/ WALTER FREDERICK FREEMAN,
500 West Broadway.

(Rank or Rating): YNC.

(Service Number): 151-61-65.

City: San Diego.

(State): California.

Enl Ret 1

[Endorsed]: Filed November 2, 1956.

U. S. NAVY FINANCE CENTER
CLEVELAND 14, OHIO

BLOCK TYPE 2

02

BLOCK NUMBER	
EXP. ACCT. CODE	02
STOP SERV. NO.	151 61 65
START SERV. NO.	151 61 65

STATISTICAL CODES (Navy Finance Center use only)

DESTINATION	SAVED PAY	CLASSIFICATION	FAMILY STATUS	SERVICE	RANK	CORPS	SPECIAL
	1	23	E	24	56	9	

Walter F. FREEMAN
1501 Fifth Ave.
San Diego, Calif.

PREPARED BY 67/40

DATE 12/30/55

ACTION EFFECTIVE MONTH January YEAR 1956

...IONS	MO. GROSS PAY	ACTION CODE	*TAXABLE INCOME	*WITHHOLDING TAX	ALLOTMENTS	CREDITS	DEBITS	NET PAY
...MENT	191.88	05	191.88	24.20				167.68
...MT. CHECK								
...ENT CHECK 1/56	180.07	01					65.27	114.80

...e totals will be reported on your Treasury Department Withholding Form W-2.

ALLOTMENTS

STOP	START

...ON adjustment

~~r letter was received 12/13/55.~~

...accordance with Bureau of Naval Personnel letter

...s-B51/aeg of 11/8/55 and your election of Method C,

...r retired pay is reduced to Method C retroactive to

...1/49, resulting in an overpayment of 391.42 which you ~~have~~ requested, in your letter received 12/13/

...quidated in 6 months.

...27 will be deducted in 1/56 and 65.23 for the period 2/56 - 6/56.

...ll pay will be restored in 7/56.

...bit difference in pay 163.35 vs 167.58 10/1/49 - 4/30/52 131.13

...bit difference in pay 169.88 vs 174.28 5/1/52 - 3/31/55 154.00

...bit difference in pay 180.07 vs 191.88 4/1/55 - 12/31/55 106.29

391.42 total debit

...bit overpayment @ 65.27 1/56 - 65.27

[Back]

Refund of tax withheld for prior yea... should be requested from your local Director of Internal Revenue.

Endorsed: Filed November 2, 195...

...ROLL COMPUTING FORM
4ND-3365 (NAVY-PC/1286 Rev. 2-55)

PLAINTIFF'S EXHIBIT No. 7

CA35/P16-4/MM

U. S. S. Indianapolis

San Pedro, California.
26 June, 1939.

From: Commanding Officer.
To: Freeman, Walter Frederick, No. 151-61-65, CY(PA), U.S.N.

Subject: Orders—Transfer to Fleet Reserve, Class F-4-D, and release from active duty.

Reference: (a) BuNav Ltr. Nav-66-HJP, dated 23 May, 1939.

1. By direction of the Bureau of Navigation you are hereby transferred from the Regular Navy to inactive status in the Fleet Reserve, Class F-4-D. You are released from all active duty effective this date. After transfer you are free to accept employment and to take up your residence wherever you desire, but you will remain subject to the rules and regulations prescribed by competent authority for the government of the Fleet Reserve Force. You are required to keep U. S. Navy uniform on hand and in good condition at all times for use in case you are ordered to active duty. You will keep yourself in readiness for service in case of war or national emergency.

2. The Commandant, Eleventh Naval District, San Diego, California, will be your Commanding

Officer while on inactive duty status and all requests for active duty, etc., will be made to him. You will keep the Commandant, Eleventh Naval District, informed of your home address; will answer promptly all letters addressed to you by proper authority; and will inform the Commandant, Eleventh Naval District, of any change in your health which might prevent service at sea in time of war. You have given as your address on transfer to the Fleet Reserve as:

Cecil Hotel, Los Angeles, California.

3. Fleet Reservists are encouraged to maintain touch with the Recruiting Stations, Naval Station, and other Naval activities nearest their homes.

4. Your Fleet Reserve pay will be forwarded to you monthly by check, at the address as given by you above, by the Disbursing Officer, Bureau of Supplies and Accounts (Retainer Pay Division), Navy Department, Washington, D. C., and you will inform the Disbursing Officer of any change in the above address.

/s/ J. F. SHAFROTH.

Copy to: BuNav
Comdt. 11th NavDist

[Endorsed]: Filed November 2, 1956.

PLAINTIFF'S EXHIBIT No. 8

Commandant's Office
Eleventh Naval District
San Diego, California

11 September, 1939.

Refer to No.:
QR/ND11/B-We

From: Commandant.
To: Freeman, Walter Frederick, CY(PA) 151 61 65 F4d, USFR.

Subject: Orders—Recall to active duty.

Reference:
(a) Bunav despatch 6310 1215 of 10 Sep., 1939.
(b) Your request dated 10 Sept., 1939.

1. Having requested active duty in the Eleventh Naval District, reference (b), you are hereby authorized to report to the District Medical Officer, U. S. Naval Hospital, San Diego, California, for a physical examination to determine your fitness for active duty.

2. If found not physically qualified for active duty, you will return to your home and return these orders to the Commandant for cancellation.

3. If found physically qualified for active duty, you will report immediately to the District Personnel Officer, Headquarters Eleventh Naval District, for active duty.

4. Present these orders to the District Medical Officer for the proper endorsement. Your health record can be obtained at that office.

5. Forward your Continuous Service Certificate to the Commandant in order that necessary entries may be made therein while you are on active duty.

6. Your records and accounts while on active duty will be carried at Eleventh Naval District Headquarters.

/s/ C. W. FLYNN,
By Direction.

Copy to: BuNav
S&A (RPD)
Personnel Office—11th ND
Disb. Off. RIGEL
COM 11

U. S. Naval Hospital
San Diego, California

11 September, 1939.

First Endorsement

From: Medical Officer in Command.
To: Freeman, Walter Frederick, CY, F-4-D, FNR.

1. Examined this date and found fit for all duty.

/s/ H. M. MAVEETY,
Lt. Comdr. (MC), USN,
By Direction.

P16-4/MM/QR (B-bt)

Hdqtrs., 11th Naval District
San Diego, California

11 September, 1939.

Second Endorsement

From: Commandant.
To: Freeman, Walter Frederick, No. 151 61 65, CY(PA), USFR.

1. Reported for active duty at 1000, this date.

/s/ C. W. FLYNN,
By Direction.

[Endorsed]: Filed November 2, 1956.

PLAINTIFF'S EXHIBIT No. 9

NH16/P19-2/QR1
CWF/les

U. S. Naval Hospital
San Diego, California

February 18, 1943.

From: The Medical Officer in Command.
To: Freeman, Walter Frederick, 151 61 65, CY (PA) USN.

Subject: Orders—Release from active duty and recommended to be placed on the retired list, U.S.N.

Reference:

(a) BuPers Ltr. Pers-663-HVP MM 151 61 65 of 2-6-43.

(b) Article H-96-04 Bu Nav Manual.

1. In accordance with reference (a), you are this date released from all active duty in the U. S. Naval Service.

2. In accordance with instructions contained in reference (b), you have been examined and found Not physically qualified to perform the duties of your rating at sea; it has, therefore, been recommended that you be placed on the Retired List.

3. Upon receipt of these orders and when directed by proper authority, you will proceed to your home, Army and Navy Y.M.C.A., San Diego, California, and report to the Commandant, Eleventh Naval District, San Diego, California, in writing informing him of your arrival and giving him your correct name, rate, service number and address.

4. You must at all times keep the Commandant of the Naval District in which you reside informed of your correct home address. Any change therein shall also be reported to the Bureau of Supplies and Accounts (Retainer Pay Division), Navy Department, Washington, D. C.

5. You will answer promptly all letters addressed to you by proper authority. Request to leave the Continental limits of the United States, by permis-

sion, shall be addressed to the Chief of Naval Personnel via the Commandant of your district.

GEO. C. THOMAS,

C. W. FEYH,
By Direction.

Certified a true copy.

/s/ W. A. HUNTER,
Lt. (jg), USN.

Copy to:
BuPers
Com-11

[Endorsed]: Filed November 2, 1956.

PLAINTIFF'S EXHIBIT No. 10

In Reply Refer to:
ND11/QR1/MM
Serial Q-65195(Wr)

Commandant's Office
Eleventh Naval District
San Diego, California

March 1, 1945.

From: The Commandant.

To: Freeman, Walter Frederick, 151 61 65, CY (PA), F4D, USNR, Army & Navy YMCA. San Diego, California.

Subject: Retirement as a result of physical examination.

References:

(a) BuPers ltr Pers-603-HVP, dated Feb. 6, 1943.

(b) Naval Reserve Act of 1938.

1. Reference (a) authorizes your retirement in accordance with the recommendation that you are not physically qualified to perform the duties of your rating at sea, therefore, you are placed on the retired list of the Navy as of this date.

2. For your information, the following is quoted from reference (b): "* * * Provided further, that enlisted men heretofore or hereafter transferred to the Fleet Reserve after sixteen years' or more service in the Regular Navy, who are not physically qualified upon such examination, shall be transferred to the retired list of the Regular Navy, with the pay they are then receiving."

3. Report all changes of your address to the Bureau of Supplies and Accounts (Retainer Pay Division), Washington, D. C., via the Commandant, Eleventh Naval District, in triplicate. Such reports must give the date of your retirement and be signed with your full name; they should reach the Commandant not later than the 15th of the month.

4. You are Not physically qualified for mobilization ashore.

G. M. HAVENSCROFT,
Acting Commandant.

C. H. PERDUN,
By Direction.

cc: S&A RPD (4)
BuNav
M & S
File
Orig. to man
DMO
Serial

[Endorsed]: Filed November 2, 1956.

Form 1040A
Department of the Treasury
Internal Revenue Service

EMPLOYEE'S OPTIONAL
U. S. INDIVIDUAL INCOME TAX RETURN

1952 CALENDAR YEAR

IF YOU USE THIS FORM, THE DIRECTOR OF INTERNAL REVENUE WILL COMPUTE YOUR TAX
(IF YOU WISH TO COMPUTE YOUR OWN TAX, USE FORM 1040)

Do not write in this space
Serial No. 210089600

BE SURE TO
USE ALL YOUR
EXEMPTIONS
WITHHOLDING
STATEMENTS
(Forms W-2)

Name Freeman Walter F.
(PLEASE PRINT. If this is a joint return of husband and wife, use first names of both)

HOME ADDRESS 500 West Broadway,
(PLEASE PRINT. Street and number or rural route)

San Diego 1 California
(City, town, or post office) (Postal zone number) (State)

Social Security No. 560-32-2359 Occupation U.S.N. Retired

1. List your name. If your wife (or husband) had no income, or if this is a joint return, list also her (or his) name.

	Check below if on Dec. 31, 1952, you or your wife were—	On lines A and B below— If neither 65 nor blind write the figure 1 If either 65 or blind write the figure 2 If both 65 and blind write the figure 3
A Walter F. Freeman (Your name)	65 or over ☐ Blind ☐	Number of exemptions for you 1
B (Your wife's name—do not list if exemption is claimed on another return)	65 or over ☐ Blind ☐	Number of her (or his) exemptions ...

C. List names of your children (including stepchildren and *legally* adopted children) with 1952 gross incomes of less than $600 who received more than one-half of their support from you in 1952. See Instruction 1C. (Name—and address if different from yours)

Enter number of children listed 0

D. Enter number of exemptions claimed for close relatives listed in Schedule A on other side 0

E. Enter total number of exemptions claimed in A to D above 1

2. Fill in below the information from each of your 1952 Withholding Statements (Forms W-2). If this is a joint return, enter information from withholding statements of both husband and wife.

Print Employer's Name	Where Employed (City and State)	Total Wages	Income Tax Withheld
		$2064 56	$ 22 10
	Enter totals	$2064 56	$ 22 10

3. Enter total of interest, dividends, and any wages not shown on Forms W-2. If a joint return enter total of such income of both husband and wife .. 0 00
If item 3 is over $100, or you had any other income (rent, etc.) use Form 1040.

4. Add items 2 and 3. *If total is $5,000 or more, use Form 1040* $2064 56

If item 4 includes income of both husband and wife, show: husband's income $.....; wife's income $.....

owe any prior year Federal tax for which you have been billed? (Yes or No) No Is your wife (or husband) making ate return for 1952? (Yes or No) — If "yes," write her (or his) name .....
have filed a return for a prior year, state latest year 1951 Where filed? Los Angeles Cal.

declare under the penalties of perjury that the foregoing statements are true to the best of my knowledge and belief; at *all 1952 income is reported hereon.*

e of person, other than taxpayer, preparing this return) (Date)

Walter F. Freeman 1-29-53
(Signature of taxpayer) (Date)

(Address)

(Signature of taxpayer's wife or husband if this is a joint return) (Date)

o assure any benefits of split-income provisions, husband and wife must include all their income and, even though only one has income, BOTH MUST SIGN.

THIS SPACE FOR DIRECTOR'S USE ONLY
TAX DUE OR REFUND WILL BE COMPUTED BY DIRECTOR

Credits	$ 22 10
Tax	$
Balance due or refund .	$
	$
Total ..	$

Endorsed: Filed November 2, 1956.

United States District Court for the Southern District of California, Southern Division

No. 1661-W, Sou. Div., Civil

WALTER F. FREEMAN,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

FINDINGS OF FACT, CONCLUSION OF LAW AND JUDGMENT

The above case came on regularly for trial on July 29, 1957, before the Honorable Jacob Weinberger, United States District Judge, sitting without a jury, the plaintiff appearing through his counsel, Philip Crittenden, and the defendant appearing through its counsel, Laughlin E. Waters, United States Attorney; Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, and Rembert T. Brown, Assistant United States Attorney, by Rembert T. Brown, and a stipulation of facts having been entered into, and documentary evidence having been received, and the arguments of counsel both oral and written having been presented, the Court now finds as follows:

Findings of Fact

I.

Plaintiff, Walter F. Freeman, is a resident of the Southern District of California. [85]

II.

Plaintiff is now, and at all times herein pertinent was a citizen of the United States of America.

III.

Plaintiff filed his income tax return for the year 1952 on or before March 15, 1953, in which he reported income of $2,064.56 and income tax withheld of $22.10.

IV.

Plaintiff filed a Claim for Refund on the proper form furnished by the Department of Internal Revenue and within the time provided by law; said claim for refund was denied on May 24, 1954; said claim was based on the contention of plaintiff that the retirement pay received by plaintiff from the U. S. Navy was exempt from taxation as being retirement pay paid to a retired navy enlisted man who was retired for physical disability resulting from active service in the U. S. Navy.

V.

Plaintiff received retirement pay from the U. S. Navy during the year 1952 in the sum of $2,064.56.

VI.

The sum of $22.10 was withheld from plaintiff by the U. S. Navy as income tax withheld. If said retirement pay is taxable income, plaintiff owes the sum of $256.90 as income tax for the year 1952.

VII.

Plaintiff was an enlisted man in the U. S. Navy continuously from May 6, 1918, to June 26, 1939.

On June 26, 1939, plaintiff was transferred to the Fleet Reserve based on length of service.

VIII.

On September 11, 1939, plaintiff was recalled to active duty at Headquarters, 11th Naval District, San Diego, California. [86] At the time of his recall to active duty, plaintiff was given a physical examination and found to be physically fit for all duty.

IX.

Plaintiff was continuously on active duty from September 11, 1939, to February 18, 1943, during which entire time he was stationed on shore duty in the San Diego area. On February 18, 1943, he was released from active duty as the result of a physical examination. Said physical examination, which was made on January 5, 1943, found that plaintiff had the following defects:

(1) Arteriosclerosis, general No. 210;

(2) Vision, 10/20 left; 16/20 right; corrected to 20/20 in each eye by glasses;

(3) Varicose veins, legs and feet No. 249.

Said physical examination recommended that plaintiff was "not fit to perform active duty at sea or on foreign service" and "not physically qualified for any duty." Such recommendation was approved by the Chief of the Bureau of Medicine and Surgery on the 21st day of January, 1943, and it was further recommended that plaintiff be released from active duty and placed on the retired list.

X.

By letter order dated the 6th day of February, 1943, the Chief of Naval Personnel directed that in accordance with the recommendation of the Chief of the Bureau of Medicine and Surgery dated January 21, 1943, plaintiff be released from active duty and placed on the Retired List on the 1st day of the month following his release from active duty under the authority of the Naval Reserve Act of 1938.

XI.

In accordance with said letter order, plaintiff was released from active duty on the 18th day of February, 1943, and [87] placed on the retired list as of the 1st day of March, 1943.

XII.

After the adoption of the 1949 Career Compensation Act, the Physical Review Council of the Bureau of Personnel assigned to plaintiff a Percentage of Disability of Zero (00) and requested plaintiff to elect one of the three options available.

XIII.

In accordance with said request, plaintiff first elected Option "B" which computed compensation based on the new compensation established by the 1949 Career Compensation Act. Subsequently, plaintiff changed said election to elect Option "C" which computed compensation based on the laws in effect prior to the 1st day of October, 1949, the effective date of the 1949 Career Compensation

Act. As a result of said corrected election, all retirement pay received by plaintiff since the 1st day of October, 1949, has been based on the laws in effect prior to the 1st day of October, 1949, the effective date of the 1949 Career Compensation Act.

XIV.

On or about the 14th day of February, 1956, plaintiff filed an application with the Board for Correction of Naval Records, Department of the Navy, for the purpose of having the Percentage of Disability assigned to plaintiff by the Bureau of Personnel corrected. By letter dated the 14th day of August, 1956, the Board for Correction of Naval Records denied a hearing on such application of plaintiff on the basis that the disability rating of 0% assigned by the Physical Review Council was correct and proper and that plaintiff's medical records do not indicate that plaintiff was suffering from a disability ratable under the Schedule for Rating Disabilities in current use by the Veterans Administration at the time of plaintiff's retirement on the 1st day of March, 1943.

XV.

Plaintiff's retirement pay is based on over 24 years of [88] service; no portion of which pay is computed on the basis of a disability factor.

XVI.

Plaintiff's retirement pay since the 1st day of October, 1949, has been based on the laws in effect prior to the 1949 Career Compensation Act under

the provisions of said Act which permits retired personnel to so elect.

XVII.

Plaintiff has exhausted his administrative remedies with the Department of the Navy. Plaintiff has exhausted his administrative remedies with the Treasury Department prior to filing this action.

XVIII.

No part of the retirement pay received by the plaintiff from the United States Navy during the year 1952 was received as a pension, annuity or similar allowance for personal injuries or sickness resulting from active service in the United States Navy. The entire amount of said retirement pay was received by the plaintiff as compensation for length of service in the United States Navy.

XIX.

Any conclusion of law herein which is deemed to be a fact is hereby found as a fact and incorporated herein as a finding of fact.

Conclusions of Law

From these facts the Court concludes as follows:

I.

This Court has jurisdiction of this controversy and of the parties hereto. [89]

II.

Section 22(b) of the Internal Revenue Code of 1939, as amended by Section 113 of the Revenue Act of 1942, provides in pertinent part:

"The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

"(5) * * * amounts received as a pension, annuity or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country."

III.

An exemption from a federal internal revenue tax is a matter of legislative grace and consequently statutes providing for exemptions from such tax are to be strictly construed.

IV.

The fact that a person is permanently incapacitated for further active service in the armed forces is not determinative of the exemption status of the retirement pay received by him under the provisions of the federal internal revenue laws.

V.

The retirement pay received by plaintiff during the year 1952, being compensation for length of service, and not a pension, annuity or other allowance for personal injuries or sickness resulting from active service in the armed forces, was therefore not excludable from his taxable income under the provisions of Section 22(b)(5) of the Internal Revenue Code of 1939, as amended.

VI.

Any finding of fact which is deemed to be a conclusion of law is hereby concluded as a matter of law and incorporated herein as a matter of law. [90]

VII.

Defendant is entitled to judgment that the plaintiff take nothing by reason of this action, that the complaint be dismissed with prejudice, and that defendant have judgment on its counterclaim against the plaintiff for the sum of $256.90, together with interest and costs as allowed by law.

Judgment

In accordance with the foregoing findings of fact and conclusions of law, it is ordered, adjudged and decreed:

That the plaintiff take nothing by his complaint; that the complaint may be and is dismissed with prejudice; and that the defendant have judgment on its counterclaim for and shall recover from the plaintiff the amount of $332.57, together with the amount of its costs to be taxed by the Clerk of this Court in the sum of $20, with interest upon the total from this date until paid, according to law.

Dated: Feb. 12, 1958.

/s/ JACOB WEINBERGER,
United States District Judge.

Affidavit of Service by Mail attached.

[Endorsed]: Filed February 12, 1958.

Entered February 13, 1958. [91]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Walter F. Freeman, plaintiff above-named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on February 13, 1958.

February 27, 1958.

/s/ PHILIP CRITTENDEN,
Attorney for Plaintiff.

[Endorsed]: Filed March 10, 1958. [97]

[Title of District Court and Cause.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled case:

A. The foregoing pages numbered 1 to 99, inclusive, containing the original:

Complaint.
Answer and Counterclaim.
Answer to Counterclaim.
Substitution of Attorneys.
Defendant's Pretrial Memorandum.

Plaintiff's Pretrial Memorandum.
(Copy) Minute Order, 11/2/56.
Pretrial Stipulation and Order.
Defendant's Trial Brief.
Plaintiff's Trial Brief.
(Copy) Minute Order, 11/21/56.
Defendant's Brief re Jurisdiction of Court.
Plaintiff's Brief on Jurisdiction.
Minute Order, 5/20/57.
Defendant's Supplemental Brief.
Minute Order, 6/13/57.
Plaintiff's Supplemental Brief.
Minute Order, 7/2/57.
Defendant's supplemental Brief re the meaning of "Sickness resulting from active service," etc.
Minute Order, 7/29/57.
Minute Order, 8/6/57.
Notice of Objections to Findings of Fact, Conclusions of Law, proposed by Defendants.
Findings of Fact, Conclusions of Law and Judgment.
Defendant's Computation of the amount of Judgment, etc.
Notice of Appeal.
Designation of Record.

B. Plaintiff's Exhibits 1 to 12, inclusive.

I further certify that my fee for preparing the foregoing record, amounting to $1.60, has been paid by appellant.

Dated: April 11, 1958.

[Seal] JOHN A. CHILDRESS,
Clerk;

By /s/ WM. R. WHITE.

[Endorsed]: No. 15981. United States Court of Appeals for the Ninth Circuit. Walter F. Freeman, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Southern Division.

Filed: April 15, 1958.

Docketed: April 16, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 15981

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S STATEMENT ON POINTS ON APPEAL

Comes now the appellant herein and, pursuant to Rule 17, Rules of the United States Court of Appeals for the Ninth Circuit, hereby makes his statement of the point on which he intends to rely, as follows:

That the Hon. Jacob Weinberger, Judge of the United States District Court, Southern District of California, Southern Division, incorrectly decided and gave judgment that the appellant was not retired for physical disability resulting from active service in the armed forces of the United States, when in fact appellant was so retired from the United States Navy.

Dated this 25th day of April, 1958.

/s/ PHILIP CRITTENDEN,
Attorney for Appellant.

[Endorsed]: Filed May 1, 1958.

No. 15981

UNITED STATES
COURT OF APPEALS
for the Ninth Circuit

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF

l from the United States District Court for the
Southern District of California
Southern Division.

No. 15981

UNITED STATES
COURT OF APPEALS
for the Ninth Circuit

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court for
Southern District of California
Southern Division.

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JURISDICTION

This is an appeal from a Complaint for refund of income tax erroneously withheld by the United States Navy in January 1952 (TR pages 3-12). The United States filed its answer and counterclaimed for the sum of $256.90 plus interest for unpaid income tax assessed for the year 1952 by the Commissioner of Internal Revenue (TR pages 12-19). The plaintiff filed an answer to the counterclaim denying that said sum was due and owing (TR pages 19-20).

This action was brought by the plaintiff under paragraph (a)(1) of Section 1346 of USCA Title 28 after filing a Claim for Refund and having said Claim for Refund denied (TR page 21).

The United States District Court for the Southern District of California, Southern Division, entered its judgment against the plaintiff on the complaint and for the

United States on its counterclaim in the amount of $332.57, together with costs in the sum of $20.00, on February 13, 1958 (TR pages 51-58).

Plaintiff and appellant thereupon filed Notice of Appeal on March 10, 1958 (TR page 59), and thereafter perfected his appeal to this Court under the provisions of USCA Title 28 Section 1294 and Rules on Appeal.

Plaintiff and Appellant had exhausted all of his administrative remedies prior to filing this action. See Pretrial Stipulation and Order (TR 21,25) and Finding XVII of Findings of Fact, Conclusions of Law and Judgment (TR 51,56).

STATEMENT OF THE CASE

The appellant, Walter F. Freeman, enlisted in the United States Navy on May 6, 1918, and served continuously thereafter as an enlisted man in the United States Navy to June 26, 1939. On that date, appellant was transferred to the Fleet Reserve and released from active service (Pl's Exhibit 7, TR 41). On September 11, 1939, appellant was recalled to active duty at San Diego, California. At the time of recall to active duty, appellant was examined and found to be physically fit for all duty (Pl's Exhibit 8, TR 43). Appellant was on active duty from September 11, 1939, to February 18, 1943. On January 5, 1943, plaintiff was examined and found to have the following defects:

1. Arterio Sclerosis general 210.

2. Vision 10/20 left, 16/20 right, corrected to 20/20 in each eye by glasses.

3. Varicose veins, legs and feet, No. 249.

Said physical examination further recommended that the plaintiff was "not fit to perform active duty at sea or on foreign service" and "not physically qualified for any duty" (Finding of Fact IX, TR 53). On January 21, 1943, the Chief of the Bureau of Medicine and Surgery approved the examination and recommendation and further recommended that plaintiff be released from active duty and placed on the retired list (Finding of Fact IX, TR 53. On February 6, 1943, the Chief of Naval Personnel by letter order directed that plaintiff be released from active duty and placed on the retired list on the first day of the month following his release from active

duty under the authority of the Naval Reserve Act of 1938 (Pl's Exhibit 2, TR 27). On February 18, 1943, plaintiff was released from active duty (Pl's Exhibit 9, TR 45), and on March 1, 1943, plaintiff was placed on the retired list (Pl's Exhibit 10, TR 47).

Section 22(b)(5) of the Internal Revenue Code, as amended by Section 113 of the Revenue Act of 1942, states that retirement pay is exempt from income tax if said retirement pay is received "for personal injuries or sickness resulting from active service in the armed forces of any country."

From time of plaintiff's retirement until the year 1952, plaintiff reported his retirement pay as exempt from income tax.

In March, 1953, plaintiff filed his 1952 income tax return on Form 1040a,

showing thereon his retirement pay of $2,064.56 and income tax withheld of $22.10 (Pl's Exhibit 12, TR 50). He thereafter duly and in accordance with law filed a Claim for Refund for $22.10 which had been withheld from his retired pay for the month of January, 1952 (Finding of Fact IV, TR 52). This claim for refund was denied and this action was brought for the refund of said sum of $22.10 withheld.

SPECIFICATION OF ERROR

That the District Court erroneously decided that no part of the retirement pay received by plaintiff and appellant from the United States Navy during the year 1952 was received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the United States Navy and therefore not exempt from income tax, whereas in fact all of such retirement pay so received by plaintiff and appellant was so received and all of such retirement pay received by plaintiff and appellant from the United States Navy was exempt from income tax.

ARGUMENT

I

Appellant agrees with all of the Findings of Fact found by the District Court except Finding of Fact XVIII and any which might be incorporated as a Finding of Fact under Finding of Fact XIX and further disagrees with the Conclusions of Law and the Judgment resulting from Finding of Fact XVIII.

At the trial, all of the evidence presented was documentary and is now before this Court.

Finding of Fact XVIII that "no part of the retirement pay received by the plaintiff from the United States Navy during the year 1952 was received as a pension, annuity or similar allowance for personal injuries or sickness resulting from active service in the United States Navy" is a conclusion arrived at by the

District Court from the documentary evidence presented to that Court and which is now before this Court.

II

It is true that the amount of appellant's retirement pay is computed on length of service with no factor for disability. However, those portions of the Naval Reserve Act of 1938 under which appellant was transferred to the Fleet Reserve (Act of June 25, 1938, c. 690, Title II, Sec. 203, 52 Stat. 1178, amended Aug. 10, 1956, c. 1041, Sec. 25, 70A Stat. 631; 34 USCA Sec. 854b) and under which appellant was retired (Act of June 25, 1938, c. 690, Title II, Sec. 206, 52 Stat. 1179, as amended Apr. 25, 1940, c. 153, 54 Stat. 162; 34 USCA Sec. 854e; and Act of June 25, 1938, c. 690, Title II, Sec. 208 as added Aug. 10, 1946, c. 952, Sec. 3, 60 Stat. 994; USCA Sec. 854g) make no

provision for retirement based upon any disability factor. Under the Fleet Reserve Act of 1938, Fleet Reserve pay is one-third, one-half, or three-quarters of active duty pay, plus authorized allowances, depending upon the number of years of service, namely, sixteen years, twenty years, and thirty years, respectively. When found not physically qualified, enlisted men in the Fleet Reserve are transferred to the retired list of the Regular Navy with the pay they are then receiving in the Fleet Reserve.

The Career Compensation Act of 1949 (Oct. 12, 1949, c. 681, Title IV, Sec. 411, 63 Stat. 823; 37 USCA Sec. 281) states in part:

> ".....any member or former member of the uniformed services heretofore retired by reason of physical disability

> and now receiving or entitled to receive retirement or retirement pay..... may elect..... (B) to receive retired pay or retirement pay computed by one of the two methods contained in section 311 of this title.....".

Section 311 (Oct. 12, 1949, c. 681, Title V, Sec. 511, 63 Stat. 829; May 19, 1952, c. 310 Sec. 4, 66 Stat. 80) states in part:

> "On and after October 1, 1949 (1) members of the uniformed services heretofore retired for other than physical disability..... shall be entitled to receive retired pay, retirement pay, retainer pay or equivalent pay in the amount whichever is greater, computed by one of the following methods:

(a) The monthly retired pay, retainer pay or equivalent pay in the amount authorized for such members and former members by provisions of law in effect on the day immediately preceding October 12, 1949."

Under this provision of the law, appellant elected to continue to receive his retirement pay as computed under the Naval Reserve Act of 1938, as amended. Thus appellant's pay was computed solely on years of service.

Regardless of whether appellant was or was not retired for physical disability "resulting from service in the U.S.Navy," appellant's retirement pay would be the same under the Naval Reserve Act of 1938 and under the election made by appellant under the Career Compensation Act of 1949.

In the case of Guyla S. Prince v. United States (112 Ct. Clms. 612, 119 Fed. Supp. 421), the U.S. Court of Claims found

that a colonel who was retired because of age and recalled to active duty on the day following retirement and then three months later was found by a Retiring Board to be physically incapacitated for active service based on disabilities incurred in line of duty prior to his original retirement, should be found to have been retired for physical disability and found that his retirement pay was exempt from income tax, even though the retirement pay in either case would be based on years of service.

This case of Prince v. United States (supra) is directly on the point that even though the retirement pay is computed on years of service, without any disability factor involved, the retirement pay is still exempt if the retirement was for disability resulting from active service.

There is no question but that appellant was retired for physical disability. The record is clear that he was retired as a result of the physical examination of January 5, 1943, as set forth above under the Statement of Facts.

III

The only question is whether or not appellant was retired for physical disability resulting from active service in the United States Navy.

Sec. 22(b)(5) of the Internal Revenue Code of 1939, as amended by Section 113 of the Revenue Act of 1942, provides in pertinent part:

> "The following items shall not be included in gross income and shall be exempt from taxation under this chapter; ..... 5. .....amounts received as a pension, annuity or similar allowance for personal

injuries or sickness resulting from active service in the armed forces of any country."

In the case of William L. Neill v. Commissioner of Internal Revenue (17 TC 1015, Dec. 18, 672), the Tax Court stated that "the mere fact that he was incapacitated at the time of retirement is not sufficient to bring the exemption into play if he was actually retired for length of service rather than for disability incurred in line of duty (citing cases). It therefore becomes pertinent to inquire into the basis upon which petitioner was retired." The court then inquired into the basis on which the petitioner was retired and found that he was retired for physical disability and that his retirement pay was exempt under Section 22(b)(5) of the Code.

Under this provision of the law as interpreted by the Tax Court, if appellant

was retired for, and receives his retirement pay for, personal injuries or sickness resulting from active service in the United States Navy, such retirement pay would be exempt from income tax and appellant is entitled to the refund.

Section 402(a) of the Career Compensation Act of 1949 (63 Stat. 802, 817; 37 USCA 272(a)) states:

"That any disability shown to have been incurred in line of duty during a period of active service in time of war or national emergency shall be considered to be the proximate result of the performance of active duty."

The record shows that appellant was found "fit for all duty" on September 11, 1939 (Plaintiff's Exhibit No. 8, TR 43, 44). The Medical Record of Appellant (Plaintiff's Exhibit No. 1) shows that

the disabilities for which appellant was retired were "in line of duty." It is therefore obvious that these disabilities were incurred during the period from September 11, 1939, to the date of the physical examination which found appellant "not fit for any duty," on January 5, 1943.

A National Emergency was declared by the President of the United States on September 16, 1940, World War II was commenced on December 7, 1941, and active hostilities terminated in 1945.

Appellant was retired March 1, 1943, which was during a time of war, active warfare having commenced in 1941 and terminated in 1945.

It is therefore obvious that appellant's disabilities were "incurred in line of duty during a period of active service in time of war or national

emergency." Such disabilities, therefore, must be "considered to be the proximate result of the performance of active duty" under the presumption established by Section 402(a) of the Career Compensation Act of 1949 (supra).

The Treasury Department in I.T. 3641, 1944 Cumulative Bulletins 70, ruled that the retirement pay of officers of the Regular Army who have been retired under Section 1251 of the Revised Statutes (section 933, Title 10, USCA) for personal injuries or sickness resulting from active service in the United States Army, are not taxable for 1942 and subsequent years. There is no reason why retirement from the United States Navy should be any different as to taxability of retirement pay, and enlisted men of the armed services should receive the same treatment for their retirement pay as is given to officers of

the services. Therefore, it would appear only reasonable that this ruling should apply to applicant's retirement pay received for the year 1952.

CONCLUSION

We have shown above that appellant was retired for physical disabilities and also that under the law such disabilities must be considered to be the result of active duty in the United States Navy. This complies in all respects with the requirements of Section 22(b)(5) of the Internal Revenue Code of 1939, as amended, to make such retirement pay exempt from income tax. The District Court therefore incorrectly found that such pay was not exempt and its judgment should be reversed and a Finding of Fact entered for the plaintiff that plaintiff's retirement pay is exempt from income tax and a Judgment for plaintiff be entered in the sum of $22.10 and the defendant's cross-complaint be dismissed.

CRITTENDEN & GIBBS,
By PHILIP CRITTENDEN,
Attorney for Appellant.

APPENDIX

EXHIBITS

All exhibits were stipulated to be admitted in the Pretrial Stipulation and Order (Transcript of Record, page 21, 25) and were admitted in accordance therewith by order of the Court (TR 27).

Charles K. Rice, Assistant Attorney Gener
Lee A. Jackson, Chief, Appellate Section,
Tax Division
Department of Justice
Washington 25, D.C.

that affiant sealed said envelope and deposited the same in the U.S. Post Office at San Diego, California, on the _____ day of July, 1958, with postage thereon fully prepaid.

_____

Subscribed and sworn to before me this _____ day of July, 1958.

_____
Notary Public in and for said County and State.

No. 15981

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLEE.

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No. 15981

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLEE.

Opinion Below.

The opinion below is not reported.

Jurisdiction.

This is an action for the recovery of income taxes paid, by withholding, for the year 1952. [R. 21.] A timely claim for refund was denied on May 24, 1954. [R. 21.] On October 11, 1954 [R. 12], and within the time prescribed by Section 6532 of the Internal Revenue Code of 1954, this action was instituted in the District Court [R. 3-12], pursuant to 28 U. S. C., Section 1346.

The judgment of the District Court was entered on February 12, 1958 [R. 58], and within less than sixty days thereafter, namely, on February 27, 1958, a notice of appeal to this Court was filed [R. 59], pursuant to 28 U. S. C., Section 1291.

As hereinafter indicated, at the close of the argument, *infra,* there may be a question as to jurisdiction with regard to the taxpayer's claim for affirmative relief for the reason that the action in the District Court was instituted before the entire tax for the taxable year had been paid.

Question Presented.

Whether the retirement pay received by the taxpayer from the United States Navy during the year 1952 was received as a pension, annuity or similar allowance for personal injury or sickness resulting from active service in the United States Navy within the meaning of Section 22(b)(5) of the Internal Revenue Code of 1939.

Statute Involved.

Internal Revenue Code of 1939:

> SEC. 22 [as amended by Section 113 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. GROSS INCOME.
>
> * * * * * * * *
>
> (b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> * * * * * * * *
>
> (5) *Compensation for injuries or sickness.*—* * * amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;
>
> * * * * * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Statement.

The following is submitted as a summary of the undisputed facts as reflected in the stipulation of facts [R. 21-25]:

The taxpayer was an enlisted man in the United States Navy from May 6, 1918, to June 26, 1939, at which time

he was released from active duty and transferred to what was known as the "Fleet Reserve," the transfer being based on length of service. In September of the same year the taxpayer was recalled to active duty, given a physical examination, and found to be physically fit for all duty. The taxpayer served on active duty from September 1939 to February 1943, and was stationed on shore in the San Diego, California, area. On February 18, 1943, he was released from active duty as the result of a physical examination which disclosed that he had arteriosclerosis, defective vision (which was corrected by glasses) and varicose veins. [R. 22.]

The record accompanying the physical examination stated that the taxpayer was not fit to perform active duty or physically qualified for any duty and that he should be placed on the retired list. In accordance with this recommendation the taxpayer was released from active duty and placed on the retired list on March 1, 1943. [R. 22-23.]

With regard to his retirement pay, after the adoption of the Career Compensation Act of 1949, c. 681, 63 Stat. 802 (37 U. S. C. 1952 ed., Sec. 231), the taxpayer was advised that he had a choice of electing options for computing retirement pay under the provisions of the Act.* The taxpayer was also informed that he had been assigned a percentage disability of zero (0) for purposes of computing such pay under the above-mentioned options. The taxpayer first elected option "B" which computed compensation based on a method established by the Career Compensation Act. Subsequently, the taxpayer changed his election to option "C" which computed compensation based on laws in effect prior to the adoption of the 1949 Career Compensation Act. [R. 23.]

---

*Prior to the 1949 Act, the taxpayer's retirement pay was computed under laws then in effect. Such pay was computed on the basis of length of service only. [R. 23-24.]

In February of 1946 the taxpayer filed an application with the Board for Correction of Naval Records, Department of the Navy, for the purpose of having the percentage of disability assigned to him by the Bureau of Naval Personnel corrected. The Board for the Correction of Naval Records denied the taxpayer's application on the basis that the disability rating of zero percent already assigned by the Physical Review Council was correct and proper, and that the taxpayer's medical records did not indicate that he was suffering from a disability ratable under the schedule for rating disabilities in current use by the Veterans Administration at the time of his retirement in March of 1943. [R. 24.]

The taxpayer's retirement pay is computed and based upon over twenty-four years of active service in the United States Navy, and no portion of his pay is computed on the basis of a disability factor. [R. 24.]

In 1954 the taxpayer filed a claim with the Commissioner of Internal Revenue for refund of $22.10 withheld as income tax for the year 1952. The claim was based upon the contention that the taxpayer's retirement pay received from the Navy was exempt from tax, because it was pay received for physical disability resulting from active service. The claim for refund was denied, and it was also established that if the retirement pay is taxable income the taxpayer owes an additional tax of $256.90 for the year 1952. [R. 21.]

Upon the denial of the taxpayer's claim he filed suit in the District Court for the refund of the income tax paid for the year 1952 in the amount of $22.10. The Government filed a counterclaim against the taxpayer for the additional tax liability for the year 1952 of $256.90. The District Court denied the taxpayer's claim and granted the Government's counterclaim, from which judgment the taxpayer has appealed to this Court.

Summary of Argument.

The present case is distinguishable on its facts from both the *Prince* and *McNair* decisions. In each of those cases the Navy (or the Army) had determined that the member of the service could have been retired for disability and have been paid the same amounts as he received under his retirement for length of service. Here, the Navy has specifically determined that the taxpayer was not entitled to retirement for disability. In 1950 the taxpayer was given a physical disability rating of zero under a schedule of rating disabilities in use at the time of the taxpayer's retirement, and in 1956 this rating was reexamined and approved when the taxpayer applied for change of such rating.

It is also clear that if the taxpayer had a disability which merited rating by the Navy, the taxpayer might well receive an entirely different amount from that which he received under his retirement for length of service, contrary to the situation in the *Prince* and *McNair* cases. These facts plainly indicate that the taxpayer was not refused retirement pay on the ground that such pay would be no higher than pay computed on length of service but was refused retirement pay on the ground that he was not entitled to disability pay at all.

The courts have laid down the principle that one claiming the benefits of an exemption from taxation granted by Congress to persons of a particular status must bring himself clearly within the claimed status. This rule is particularly pertinent in the present case, for the taxpayer has presented no specific evidence to support his allegation that his retirement pay was due to personal injuries or sickness. Accordingly, the taxpayer has failed to prove that he is entitled to an exemption under Section 22(b)(5).

ARGUMENT.

The Taxpayer's Retirement Pay Was Not Received for Personal Injuries or Sickness Resulting From Active Service in the United States Navy.

The issue in this case is whether the taxpayer's retirement pay is received for personal injuries or sickness resulting from active service in the United States Navy. If the taxpayer's retirement pay was not so received, the parties have stipulated that it is taxable income. [R. 24-25.]

Section 22(b)(5) of the Internal Revenue Code of 1939, *supra,* is the provision under which the taxpayer claims that his retirement pay is not taxable. It provides that "amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country" shall be exempt from tax. The parties have stipulated [R. 24] that the taxpayer's retirement pay is computed only on the basis of length of service. This fact itself would seem to establish, under a strict interpretation of the statute, that the retirement pay is not received as compensation for personal injuries or sickness. However, the Court of Claims, *Prince v. United States,* 119 F. Supp. 421, and the United States Court of Appeals for the Fourth Circuit, *McNair v. Commissioner,* 250 F. 2d 147, have recently granted exemptions under Section 22(b)(5) in situations where the retirement pay was technically based upon length of service.

In the *Prince* case, the taxpayer, an Army Colonel, permitted himself to be retired for 30 years service in 1943, although due to his physical condition he was eligible for retirement, and for an allowance of retirement pay, based upon disability. Upon retirement, he was immediately

recalled to active duty but a few months later an Army Board found him incapacitated for active service and returned him to the lists of those retired for age. The court found that, although the pay he received would be the same whether he was retired for age or disability, he refused the more advantageous, taxwise, form of retirement through patriotism or ignorance of the law and held, one judge dissenting, that, under such circumstances, equity required a decision that his retirement pay was exempt from tax.

The *McNair* decision is very similar to *Prince*. The taxpayer, a Navy officer, was retired for age, recalled, and later found physically incapacitated and eligible for retirement for disability, but was refused disability pay on the ground that such pay would not exceed his retirement pay based only on length of service. The court held that, since the taxpayer was obviously eligible for disability pay, a fair construction of the statute would grant the tax exemption.

The instant case is distinguishable on its facts from both *Prince* and *McNair*. In each of those cases the Navy (or the Army) had determined that a member of the service could have been retired for disability and would have received the same amount as he received under his retirement for length of service. The court in each instance based its holding on the fact that the retiree was deprived of his established right to retirement on the basis of physical disability. In the present case, the Navy has specifically determined that the taxpayer is not entitled to a retirement for disability. In 1950, when the taxpayer was given an opportunity to elect to have his retirement pay computed under various options established by the Career Compensation Act of 1949, he was informed that his percentage of disability rating was zero. [R. 34.] In 1956, the tax-

payer applied for a change of this rating but was told that the Bureau of Medicine and Surgery, after a review of his medical record, concluded that the rating was correct. [R. 29-32.]

This rating of zero precludes any possibility that the taxpayer's pay is based upon physical disability or that the taxpayer is, or was ever, entitled to have retirement pay computed on the basis of physical disability. Under the Career Compensation Act of 1949, Section 402(a) (37 U. S. C. 1952 ed., Sec. 272), no disability retirement pay shall be received unless "such disability is 30 per centum or more in accordance with the standard schedule of rating disabilities in current use by the Veterans Administration." As mentioned, the taxpayer's rating under such schedule for rating disabilities is zero.

It also should be made clear that under the Career Compensation Act of 1949 the taxpayer's disability, if he had one which could be rated, might well result in his receiving an entirely different amount from that which he received under his retirement for length of service, contrary to the situation in the *Prince* and *McNair* cases. The options, outlined in the letter from the Navy in 1950 [R. 36-38], for computing retirement pay demonstrates this fact. Under Methods B or C, computed on the basis of length of service only, the taxpayer received approximately 60% of his base pay. Under Method A, depending upon the percentage of disability, the taxpayer could have received up to 75% of his basic pay, had he been eligible to compute his retirement allowance by such method. These facts show that the taxpayer was not refused retirement pay on the ground that such pay would be no higher than pay computed on the basis of length of service, but that he was not entitled to disability pay at all.

The fact that the taxpayer's retirement pay is computed under laws existing prior to the passage of the Career Compensation Act of 1949 is not important. The taxpayer's rating under the Act of a percentage disability of zero clearly demonstrates, regardless of the particular statute applicable to the computation, that the Navy has determined that there exists no disability as a basis for fixing an amount of relief for disability. The taxpayer has not shown, and has not attempted to show, that his degree of physical disability was the subject of a determination prior to 1949 for purposes of retirement pay. Therefore, in the absence of such a showing it must be assumed that the rating in 1950, under a schedule for rating disabilities in use by the Veterans Administration at the time of the taxpayer's retirement in 1943 [R. 32], is representative of the taxpayer's actual condition at the time of his retirement. Even the *Prince* decision (p. 424) noted that where there has been no determination as to the extent of disability as a basis for fixing an amount of relief for disability, no exemption is warranted. See also *Simms v. Commissioner,* 196 F. 2d 238 (C. A. D. C.). In the same vein, where the determination has been that there is no disability sufficient to warrant a computation of retirement pay based on disability, no exemption is warranted.

The *McNair* case also supports this proposition by noting that other decisions in this field, *Scarce v. Commissioner,* 17 T. C. 830; *Pangburn v. Commissioner,* 13 T. C. 169; *Simms v. Commissioner, supra,* which have refused to grant Section 22(b)(5) exemptions, may be distinguished on the facts. The obvious distinction is that in *McNair* the Navy recognized that the taxpayer could have been retired for a disability which would have resulted in allowance of disability pay, whereas in other cases, as in the present case, there was no evidence in the record that

disabilities had been recognized for purposes of the allowance of disability pay.

The courts have reiterated again and again that one claiming the benefits of an Act of Congress passed for a particular class, or one claiming an exemption from taxation granted by Congress to persons of a particular status, must bring himself clearly within the claimed class or status, and that Acts of this character are thereby strictly construed. *Commissioner v. Connelly,* 338 U. S. 258; *Mitchell v. Cohen,* 333 U. S. 411; *United States v. Popham,* 198 F. 2d 660 (C. A. 8th). This rule is particularly pertinent in this type of case. Here, other than a general allegation, the taxpayer has presented no specific evidence which would support his contention that his retirement pay was due to personal injuries or sickness resulting from active service. Accordingly, the taxpayer has failed to show that he is entitled to the exemption provided by Section 22(b)(5).

Before closing, we feel it our duty to call to the Court's attention a matter which affects the jurisdiction in this case. The record shows that this action was instituted before the taxpayer had paid the entire amount of income tax for the taxable year 1952. [R. 21, 58.] By a recent decision of the Supreme Court, it has now become settled that the courts have no jurisdiction over a suit for refund prior to the payment of the entire tax for a given year. *Flora v. United States,* 357 U. S. 63. In the present case, although the Government answered the complaint and filed a counterclaim against the taxpayer for the balance of the unpaid tax, these pleadings cannot waive or cure the jurisdictional defect because it is well settled that parties by their action cannot confer upon the courts jurisdiction over the subject matter of the action where such jurisdiction does not exist.

While the Court lacks jurisdiction over the taxpayer's claim for affirmative relief, there is no corresponding jurisdictional failure with regard to the Government's counterclaim. It has been held that if a plaintiff's action is dismissed, the dismissal does not preclude a trial and determination of the issue presented by the counterclaim, where the court's jurisdiction over the counterclaim has an independent basis. *Isenberg v. Biddle,* 125 F. 2d 741 (C. A. D. C.); *Switzer Bros. v. Chicago Cardboard Co.,* 252 F. 2d 407 (C. A. 7th). See also, *Lion Mfg. Corporation v. Chicago Flexible Shaft Co.,* 106 F. 2d 930 (C. A. 7th). Here, the Court's jurisdiction over the counterclaim rests upon Section 7401 of the Internal Revenue Code of 1954, whereas, jurisdiction over the taxpayer's suit must necessarily depend upon the provisions of Section 1346(a)(1) of Title 28, U. S. C.

Accordingly, although this Court may wish to remand the taxpayer's claim for affirmative relief to the District Court with instructions to dismiss for lack of jurisdiction, the Court clearly has jurisdiction over the Government's counterclaim, and the judgment upon the counterclaim should be sustained on its merits.

Conclusion.

For the foregoing reasons, the judgment of the District Court should be affirmed.

Respectfully submitted,

Charles K. Rice,
Assistant Attorney General.

Lee A. Jackson,
A. F. Prescott,
S. Carter Bledsoe,
Attorneys,

No. 15981

UNITED STATES
COURT OF APPEALS
for the Ninth Circuit

WALTER F. FREEMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S REPLY BRIEF

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ppeal from the United States District Court for t

Southern District of California,

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STATEMENT OF FACTS

There is an incorrect statement of facts made by Appellee. On page 4 of Appellant's Brief, commencing on the first line, Appellant states: "In February of 1946 the taxpayer filed an application with the Board for Correction of Naval Records.....". This statement should be: "In February of 1956, after this action was filed, and at the suggestion of the Assistant U.S. Attorney, the Appellant filed an application with the Board for Correction of Naval Records."

This was filed by Appellant when the Assistant U.S. Attorney stated that he would oppose this action unless Appellant so requested on the basis that Appellant had not exhausted his administrative remedies. Rather than have opposition on this score, Appellant filed an application with the Board for Correction of Naval

Records in order to eliminate this cause for opposition by the Assistant U.S. Attorney. It was then, and still is, Appellant's opinion that the percentage of disability rating had nothing to do with this case.

SUMMARY OF ARGUMENT

The matter of percentage of disability had nothing whatever to do with Appellant's retirement pay as his pay is computed under the laws in effect prior to the Career Compensation Act of 1949. Percentage of disability applies only to new options under this Act which were not elected by Appellant.

30% disability requirement in Section 402(a) of the Career Compensation Act of 1949 does not apply to persons retired prior to the Act. Furthermore, this 30% disability requirement is waived for persons, such as Appellant, who have completed over 20 years of active service.

Appellant was retired after over 24 years of almost continuous service with a determination that his physical disability was "in line of duty" and he was retired as being"not physically fit for any duty."

Appellant had reported his retirement pay as exempt from income tax until in 1952 the U.S. Navy withheld, through error, from Appellant's retirement pay the amount sued for by Appellant.

The primary difference between this present case and the Prince case is that in the Prince case the taxpayer was a commissioned officer and the Army Board acted on his retirement while in this case the Appellant is an enlisted man and it required only a recommendation by a Naval Surgeon.

As to the question of jurisdiction, the Flora case does not apply to this case as the Flora case states only that partial payment of a deficiency assessment must be paid in full while, in the present case, Appellant is claiming a refund of the entire amount withheld from his retirement pay in the year 1952 and his payment is not a partial payment of a deficiency assessment

ARGUMENT

The Argument of Appellee has a number of incorrect statements.

First, the Navy Department has not determined that taxpayer is not entitled to retirement for disability. This matter of percentage of disability assigned under the Career Compensation Act has nothing whatever to do with Appellant's retirement pay. Percentage of disability applies only to certain options authorized under the Career Compensation Act. These were the new options established by that Act and which were not elected by Appellant. Appellant elected to have his pay continue to be computed on the basis of the laws in effect prior to the effective date of the Career Compensation Act. Prior to the Career Compensation Act there was no percentage of disability assigned. This was a new concept established by this Act

and applied only to certain options authorized thereunder and which Appellant did not elect.

Appellee's reference to Section 402(a) of the Career Compensation Act of 1949 (37 U.S.C. 1952 ed. Sec. 272) on page 8 of the Appellee's Brief has no bearing whatever on this present case. The portion cited by Appellee applies only to temporary retirement of persons for physical disabilit after the effective date of the Career Compensation Act. Appellant was retired in 1943, many years prior to the adoption of this Act and his pay is computed on the basis of Sections 281 and 311 of 37 USCA, as set forth in Appellant's Opening Brief. Furthermore, 37 USCA 272(f) waives the 30% per centum requirement for persons "who shall have completed at least twenty years of active service." Appellant had over twenty years of active service.

The record is clear that after continuous active service by Appellant from May 6, 1918 to February 18, 1943, except for a period of two and one-half months in 1939, Appellant was found to be physically disabled "in line of duty" and "not physically fit for any duty" and retired from the U.S. Navy. How much clearer can it be set out that Appellant was retired for physical disability "resulting from active service" in the U.S. Navy without an actual finding to that effect. Appellant is and has been receiving retirement pay from the U.S. Navy ever since his retirement on March 1, 1943, based on laws in effect prior to the Career Compensation Act of 1949.

For the entire period prior to the year 1952, Appellant had always reported his retirement pay as exempt from income tax and such claim of exemption had never been questioned by the Treasury Department. It

was not until 1952, when an error was made by the U.S. Navy and income tax was withheld from Appellant's retirement pay, that the exempt status of this pay was questioned by the Treasury Department.

Appellee has attempted to distinguish this case from that of Guyla S. Prince v. United States (112 Ct.Clms. 612, 112 Fed. Supp. 421) on the ground that in the Prince case the right of the retiree to retire for physical disability was determined while in this present case there is no such finding. This is not true. The primary difference between this case and the Prince case is that in the Prince case the retiree was an officer and action was taken by the Army Board. In the Present case, the Appellant was an enlisted man and the only action required to retire Appellant was a recommendation by the Surgeon General of the Navy and

approval of such recommendation by the Chief of the Bureau of Personnel. No board was required and therefore there was not the detailed findings made by a board. The findings of the Naval Surgeon, as shown by the Medical Record of the Appellant (Plaintiff's Exhibit No. 1), as approved by the Surgeon General and the Bureau of Personnel, is the substitute for a Naval Board, which would have been required if Appellant had been a commissioned officer.

In answer to Appellee's statement that under the decision of the Supreme Court in Flora v. United States, 357 U.S. 63, the courts have no jurisdiction over a suit for refund prior to the payment of the entire tax for a given year, this is not the decision in the Flora case. The Flora case holds that where a deficiency is assessed the taxpayer may not pay only a

part of the assessment and then sue for a refund but must pay the entire deficiency before suing for a refund. In this case, the amount claimed as a refund was withheld from Appellant's retirement pay and was not a part of a deficiency assessment. In this connection, on October 2, 1953 Appellant was advised by the District Director of Internal Revenue as follows: "Since your income tax return for 1952 was filed on Form 1040A and the retirement pay was reported thereon, it is the opinion of this office that the assessment of tax under section 51(f) of the Internal Revenue Code does not constitute a "deficiency" within the meaning of section 271 of the Code, and that the Tax Court of the United States has no jurisdiction over the case." The letter further sets forth the procedure of filing a claim for refund and, if denied, the

filing of a suit for refund in the District Court.

This case does not come within the decision in Flora v. United States, supra, as that case applies to a suit for refund after partial payment of a deficiency assessment. This is a suit for refund of the entire amount wrongfully withheld by the United States Navy from Appellant's retirement pay and thereafter paid over to the Treasury Department and has nothing to do with a partial payment of a deficiency assessment.

CONCLUSION

For the foregoing reasons and for the reasons set forth in Appellant's Opening Brief, the judgment of the District Court should be reversed and a Finding of Fact entered for plaintiff, finding that plaintiff's retirement pay is exempt from income tax and a Judgment for plaintiff be entered in the sum of $22.10 and the defendant's cross-complaint be dismissed.

CRITTENDEN & GIBBS,
By PHILIP CRITTENDEN,
Attorney for Appellant.

State of California)
County of San Diego) ss

_____, being first duly sworn, deposes and says:

That ___ he is a citizen of the United States, resident of San Diego County, over eighteen years of age, not a party to the within cause and has business office at office of attorneys for Appellant, Crittenden & Gibbs, 602 Scripps Building, 525 C Street, San Diego, California; that the names and addresses of the attorneys for appellee are as follows:

Laughlin E. Waters, United States Attorney
Edward R. McHale, Assistant United States Attorney
808 Federal Building
Los Angeles 12, California

Charles K. Rice, Assistant Attorney General
Lee A. Jackson, Chief, Appellate Section, Tax Division
Department of Justice
Washington 25, D. C.

that in each of said places there is delivery service of United States mail, and between said two places there is regular communication by mail; that affiant enclosed _____ copies of Appellant's Reply Brief in an envelope addressed to said attorneys, as follows:

Laughlin E. Waters, United States Attorney
Edward R. McHale, Assistant United States Attorney
808 Federal Building
Los Angeles 12, California

that affiant enclosed ____ copies of

Appellant's Reply Brief in an envelope addressed to said attorneys as follows:

Charles K. Rice, Assistant Attorney General
Lee A. Jackson, Chief, Appellate Section,
Tax Division
Department of Justice
Washington 25, D.C.

that affiant sealed said envelope and deposited the same in the U.S. Post Office at San Diego, California, on the _____ day of August, 1958, with postage thereon fully prepaid.

_____

Subscribed and sworn to before me this _____ day of August, 1958.

_____
Notary Public in and for said County and State.

No. 15982

United States
Court of Appeals
for the Ninth Circuit

LESLY COHEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-13-58

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
703 Market St.,
San Francisco 3, Calif.,

For the Petitioner.

CHARLES K. RICE,
Asst. U. S. Attorney General;

LEE A. JACKSON,
Attorney, Dept. of Justice,
Washington 25, D. C.,

For the Respondent.

The Tax Court of the United States

Docket No. 46719

LESLY COHEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bureau Symbols IRA:90-D:HM) dated November 25, 1952, and, as the basis for his proceeding, alleges as follows:

1. The petitioner is an individual, residing at 471-12th Avenue, San Francisco, California. The returns for the period here involved were filed with the Collector for the First Collection District of California.

2. The Notice of Deficiency (copy of which is attached hereto and marked Exhibit "A"), was mailed to the petitioner on November 25, 1952.

3. The taxes in controversy are income tax deficiencies and penalties for the taxable years ended, respectively, December 31st, 1948, 1949 and 1950 in the following amounts:

Year		Deficiency	Penalty
1948	Income tax	$ 538,911.40	$269,455.70
1949	Income tax	426,038.44	213,019.22
1950	Income tax	228,561.34	114,280.67
	Total	$1,193,511.18	$596,755.59

The entire amounts set forth above are in dispute.

4. The determination of tax set forth in the said Notice of Deficiency is based upon the following errors:

Increases in business income for the taxable years ended, respectively, December 31, 1948, 1949 and 1950 as hereinafter set forth:

Year	Increase in Business Income
1948	$693,189.62
1949	$542,478.73
1950	$326,095.00

The facts upon which petitioner relies as the basis of this proceeding are as follows:

I.

For all taxable years involved, petitioner kept his books and filed his income tax returns upon the calendar year and cash bases. Within the time allowed by law therefor, petitioner filed his income tax returns for each of the taxable years involved with the Collector of Internal Revenue for the First Collection District of California.

II.

During the taxable years involved, petitioner owned and operated, as sole proprietor, a business establishment known as the Kingston Club, which said Kingston Club was located at 111 Ellis Street,

San Francisco, California. Petitioner caused true and complete books of account to be maintained in respect of all of the transactions of the said Kingston Club, which books were kept by a reputable, duly licensed public accountant, with offices at San Francisco, California. Said books correctly reflected all income from the operations of the said Kingston Club for each of the taxable years in question.

III.

During the taxable years involved, petitioner caused true and complete books of account to be maintained of all transactions other than the operation of the said Kingston Club which said books of account were kept by a reputable firm of Certified Public Accountants with business offices at San Francisco. Said books of account correctly reflected all income from the transactions other than the operation of the said Kingston Club for each of the taxable years involved.

IV.

The said firm of Certified Public Accountants prepared petitioner's income returns for each of the taxable years involved, based upon the books of account aforesaid, maintained, respectively, for the Kingston Club and the transactions other than the Kingston Club. Said income tax returns correctly reflected petitioner's gross and net incomes for each of the taxable years involved.

V.

Respondent arbitrarily disregarded petitioner's books of account and recomputed petitioner's tax-

able income for each of the taxable years in question by wholly arbitrary methods and without disclosing in his said Notice of Deficiency the basis of his computations. Respondent's determination of petitioner's income and tax liability for each of the years involved as set forth in the said Notice of Deficiency is without any basis in fact, and wholly arbitrary.

VI.

All of petitioner's income tax returns for the years in controversy were prepared and filed with all due care and in the bona fide belief that they reflected petitioner's true taxable income and tax liability for each of the years in question. At no time did petitioner have any intent to understate his income or evade taxes. The assertion by the respondent of a fifty per cent fraud penalty with respect to the taxable years involved as set forth in the said Notice of Deficiency is without any basis in fact and wholly arbitrary.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that there is no income tax deficiency and no penalty due for any of the taxable years involved.

/s/ JOHN V. LEWIS,

/s/ CLYDE C. SHERWOOD,
Attorneys for Petitioner.

Duly verified.

EXHIBIT A

Copy

U. S. Treasury Department
Office of Internal Revenue Agent in Charge
74 New Montgomery Street
San Francisco 5, California

Nov. 25, 1952.

San Francisco
IRA:90-D:HM

Mr. Lesly Cohen,
471-12th Avenue,
San Francisco, California.

Dear Mr. Cohen:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1948, to December 31, 1950, inclusive, discloses a deficiency of $1,193,511.18 plus penalty of $596,755.59 as shown in the statement attached. Assessment of such deficiency or deficiencies has been made under the provisions of the internal revenue laws applicable to jeopardy assessments.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not

exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Very truly yours,

JOHN S. GRAHAM,
Acting Commissioner;

By /s/ HENRY J. BRU,
Internal Revenue Agent in Charge.

Enclosures:
Statement
Form 1276
HM

San Francisco
IRA:90-D:HM

Statement

Mr. Lesly Cohen
471 Twelfth Avenue
San Francisco, California

Tax Liability for the Taxable Years Ended December 31, 1948, to December 31, 1950, Inclusive

Deficiency and Penalty Assessed October 28, 1952

Telegraphic Special No. 13 List First California District

Year		Deficiency	Penalty
1948	Income tax	$ 538,911.40	$269,455.70
1949	Income tax	426,038.44	213,019.22
1950	Income tax	228,561.34	114,280.67
	Total	$1,193,511.18	$596,755.59

The determination of your tax liability and penalty is made on the basis of information on file in this office.

The 50 per cent penalty shown herein has been asserted under the provisions of section 293(b) of the Internal Revenue Code.

Adjustments to Net Income
Year: 1948

Net income as disclosed by return		$ 24,540.94
Unallowable deductions and additional income:		
(a) Interest	$ 159.12	
(b) Business income	693,189.62	693,348.74
Net income as adjusted		$717,889.68

Explanation of Adjustments

(a) Income is increased by $159.12 representing interest received on a refund of Federal income tax, which was not included in income as reported.

(b) Available information discloses that income in the amount of $693,189.62 was not included in the net income as reported.

Computation of Alternative Tax
Year: 1948

Income subject to tentative tax (separate return)		$717,289.68
Less: Excess of net long-term capital gain over net short-term capital loss (separate return)		216.15
Balance subject to tentative tax		$717,073.53
Tentative tax		$627,356.92
Tax reduction:		
Over $100,000.00	$ 12,020.00	
9.75% on $527,356.92	51,417.30	
Total tax reduction		63,437.30

Combined partial normal tax and surtax		$563,919.62
Add: 50% of excess of net long-term capital gain over net short-term capital loss (separate return)		108.08
Alternative tax		$564,027.70

Computation of Income Tax
Year: 1948

Net income	$717,889.68	
Less one exemption at $600.00	600.00	
Normal tax and surtax net income	$717,289.68	
Tentative tax		$627,553.61
Less: Over $100,000.00	$ 12,020.00	
9.75% on $527,553.61	51,436.48	63,456.48
Balance		$564,097.13
Total alternative tax		$564,027.70
Limited to 77%		$552,775.05
Correct income tax liability		$552,775.05
Income tax disclosed by return, Original, Account No. 31930086, First California District	$ 8,357.98	
Additional, Account No. 516528, May 24, 1951, List	5,505.67	$ 13,863.65
Deficiency in income tax		$538,911.40
50% penalty		$269,455.70

Adjustments to Net Income
Year: 1949

Net income as disclosed by return	$ 35,740.69
Unallowable deductions and additional income:	
(a) Business income	$542,478.73
Net income as adjusted	$578,219.42

Explanation of Adjustments

(a) Available information discloses that income in the amount of $542,478.73 was not included in the net income as reported.

Computation of Income Tax
Year: 1949

Net income	$578,219.42	
Less: One exemption at $600.00	600.00	
Normal tax and surtax net income	$577,619.42	
Tentative tax		$500,453.67
Less: Over $100,000.00	$ 12,020.00	
9.75% on $400,453.67	39,044.23	51,064.23
Balance		$449,389.44
Total income tax—twice the above balance—Limitation 77%		$445,228.95
Correct income tax liability		$445,228.95
Income tax disclosed by return, Original, Account No. 319307, June, 1950, List First California District	$ 14,501.28	
Additional, Account No. 516529, May 24, 1951, List	4,689.23	$ 19,190.51
Deficiency in income tax		$426,038.44
50% penalty		$213,019.22

Adjustments to Net Income
Year: 1950

Net income as disclosed by return (loss)	($ 24,845.14)
Unallowable deductions and additional income:	
(a) Business income	$326,095.00
Net income as adjusted	$301,249.86

Explanation of Adjustments

(a) Available information discloses that income in the amount of $326,095.00 was not included in income as reported.

Computation of Income Tax
Year: 1950

Net income	$301,249.86	
Less: One exemption at $600.00	600.00	
Normal tax and surtax net income	$300,649.86	
Tentative tax		$248,411.37
Less: Over $100,000.00	9,016.00	
7.3% on $148,411.37	10,834.03	19,850.03
Correct income tax liability		$228,561.34
Income tax disclosed by return, Original, Account No. 3125839, First California District		0.00
Deficiency in income tax		$228,561.34
50% penalty		$114,280.67

Received and filed February 2, 1953, T.C.U.S.

Served February 3, 1953.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed

by the above-named petitioner, admits, denies, and alleges as follows:

1, 2. Admits the material allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income tax deficiencies and penalties for the taxable years 1948, 1949, and 1950; denies the remaining material allegations contained in paragraph 3 of the petition.

4. Denies that the Commissioner erred in the manner and form as alleged in paragraph 4 of the petition.

5. Admits that for all taxable years involved petitioner filed his income tax return on the calendar year and cash basis, and that said income tax returns were filed for each of the taxable years with the Collector of Internal Revenue for the First District of California; denies the remaining material allegations contained in paragraph 5.I of the petition.

5.II. Admits that during the taxable years involved petitioner owned and operated as sole proprietor a business establishment known as the Kingston Club, which said Kingston Club was located at 111 Ellis Street, San Francisco, California; denies the remaining material allegations contained in paragraph 5.II of the petition.

5.III. Denies the material allegations contained in paragraph 5.III of the petition.

5.IV. Admits that a firm of certified public accountants prepared petitioner's income tax returns for each of the taxable years involved; denies the remaining material allegations contained in paragraph 5.IV of the petition.

5.V, VI. Denies the material allegations contained in paragraphs 5.V and 5.VI of the petition.

6. Denies generally and specifically each and every material allegation contained in the petition not hereinbefore admitted, qualified, or denied.

7. Further answering the petition herein, the respondent alleges as follows:

(a) That the petitioner, during the years 1948 to 1950, inclusive, and prior thereto, was engaged in various business activities, inter alia, as a bookmaker and betting commissioner in the City of San Francisco, California, and elsewhere.

(b) That for the taxable year 1948 petitioner derived a taxable net income of not less than $717,889.68, as shown by his adjusted bank accounts, of which amount he omitted from the return as filed by him for said year the amount of $693,189.62, as set forth in the notice of deficiency attached to the petition.

(c) That for the taxable year 1949 petitioner derived a taxable net income of not less than $578,219.42, as shown by his adjusted bank accounts, of which amount he omitted from the return as filed

by him for said year the amount of $542,478.73, as set forth in the notice of deficiency attached to the petition.

(d) That for the taxable year 1950 petitioner derived a taxable net income of not less than $326,095.00, as shown by his adjusted bank accounts, of which amount he omitted from the return as filed by him for said year the amount of $326,095.00, as set forth in the notice of deficiency attached to the petition.

(e) That petitioner, on the individual income tax returns filed by him for the years 1948 to 1950, inclusive, reported an income tax liability as follows:

1948	$ 8,357.98
1949	14,501.28
1950	None

when he then and there well knew that his true liability for income tax for 1948 was $552,775.05; for 1949 it was $445,228.95, and for 1950 it was $228,561.34.

(f) That notwithstanding that for the years 1948 to 1950, inclusive, petitioner well knew that he had derived an income and incurred a tax liability as set forth in the preceding paragraphs and in the notice of deficiency from which the appeal is taken, nevertheless, with fraudulent intent, and for the purpose of concealing his true income and defrauding and deceiving the respondent and the United States, petitioner wilfully and knowingly reported

an income for each of the taxable years in an amount substantially less than his true income.

(g) That by reason of the premises, the return as filed by petitioner for each of the taxable years 1948, 1949, and 1950, as aforesaid, is a false and fraudulent return filed with intent to evade tax, and the deficiency in income tax for each of the years 1948 to 1950, inclusive, is due to fraud with intent to evade tax.

Wherefore, it is prayed that the petitioner's appeal be denied, and, further, that the Court redetermine and hold (1) that the deficiencies in income tax and penalties for the years and in the amounts set forth in the notice of deficiency be in all respects approved; (2) that the return as filed by petitioner for each of the taxable years 1948 to 1950, inclusive, is a false and fraudulent return filed with intent to evade tax; (3) that the deficiency in income tax for each of the taxable years 1948, 1949, and 1950 is due, in whole or in part, to fraud with intent to evade tax.

/s/ CHARLES W. DAVIS,
Chief Counsel, Bureau of
Internal Revenue.

Filed March 31, 1953, T.C.U.S.

The Tax Court of the United States

Docket No. 46719

In the Matter of:

LESLY COHEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

TRANSCRIPT OF PROCEEDINGS

San Francisco, California, March 28, 1956.

(Met pursuant to call of the calendar.)

Before: Honorable Morton P. Fisher, Judge.

Appearances:

JOHN V. LEWIS and
CLYDE C. SHERWOOD
703 Market Street, San Francisco, California, Appearing for the Petitioner.

CHARLES W. NYQUIST,
HONORABLE JOHN POTTS BARNES,
Chief Counsel, Bureau of Internal Revenue, Appearing for the Respondent.

The Clerk: Docket 46719, Lesly Cohen.

Will counsel please state your appearances for the record.

Mr. Sherwood: Clyde C. Sherwood for the Petitioner.

Mr. Lewis: John V. Lewis for the Petitioner.

Mr. Nyquist: Charles W. Nyquist for the Respondent.

The Court: You may proceed.

Opening Statement on Behalf of Petitioner

Mr. Sherwood: If the Court please, in this case the Commissioner of Internal Revenue has levied a jeopardy assessment, and has determined a deficiency based upon a claim that Petitioner failed to report all of his income for the calendar years 1948, 1949 and 1950. I believe that the time which this hearing will require will be materially reduced and the issues clarified if I make a rather complete opening statement concerning what the Petitioner's proof will consist of.

The Petitioner, Lesly Cohen, was born in San Francisco and educated in its schools. He went to work on the old San Francisco Bulletin as a copy boy and eventually became a sports writer and member of the sports staff. In this capacity he became recognized authority on sports events. The Bulletin was eventually sold to the San Francisco Call and is now published as the Call-Bulletin. Petitioner became a free-lance writer on sports subjects and editor of two boxing magazines. He also handled a wire for the Associated Press and did [2*] publicity work for boxing and other sports events.

***Page numbering appearing at top of page of original Reporter's Transcript of Record.**

During World War II he was inducted into the United States Army and upon his discharge returned to his native San Francisco.

In San Francisco a Mr. Coplin owned and operated the Kingston Club. This club was a legal card room, and its operation was not in violation of the laws of the State of California or the ordinances of the City and County of San Francisco. However, Mr. Coplin conducted another business on the same premises which was contrary to both State and local law. This latter business was that of a betting commissioner, and under Coplin was largely confined to wagering on horse races. There was a great post-war interest in all sorts of sports events, and Mr. Coplin desired to expand the business to embrace all sorts of athletic events in addition to horse racing. Because of Petitioner's expert knowledge of sports events, Mr. Coplin invited him to come into the business as a limited partner.

About the end of 1947 Mr. Coplin died, and Petitioner arranged with his estate to take over the operation of the business. Thereafter, until the effective date of the Federal Gambling Stamp Tax Law, Petitioner operated the card room and the betting commissioner business as sole proprietor. Petitioner filed income tax returns for the years in question and maintains that the income disclosed by these returns was and is correct. [3]

He is unmarried and lived in his mother's home with several of his brothers and sisters. His expenditures for living expenses and personal withdrawals during the period here involved were modest and

well within the income disclosed by his tax returns. His net worth at the beginning and end of each of the years here involved is consistent with his reported earnings. In short, none of the usual circumstances which tend to bolster the Commissioner's determination of unreported income are present in this case. Apparently the Respondent does not question Petitioner's return of income and expense from the card room at the Kingston Club.

The Kingston Club maintained, and we have present here in Court, complete and detailed records of its income and expense. These were taken off monthly by the accountant and appear upon summaries which will be introduced in evidence.

Petitioner was unable to maintain a similar set of records for his betting commissioner's business because the possession of such records would be incriminating if they fell into the hands of law-enforcement officers and would also be embarrassing to his customers. It therefore becomes necessary for us to go into the method by which the Petitioner conducted his business and arrived at his gross and net income from that business.

Petitioner was not engaged in gambling. His function as a betting commissioner was to bring together the parties [4] to a wager for a commission. Petitioner would quote prevailing odds on races and athletic events, and if a customer wished to make a wager, Petitioner would find others to cover the bet. Through connections with brokers in other cities and with other brokers in this immediate area, Petitioner would cover bets which he was unable to place

among his own customers. This is known as "laying off bets." Petitioner's normal commission was 5% of the total amount of the wager.

However, he never voluntarily carried any part of the wagers himself, and sometimes had to forego part or all of his commission in order to dispose of one side of a wager to another broker. In some instances the 5% commission was divided with the other broker, but in other instances it was necessary to give up the commission entirely in order to cover the risk.

Occasionally, Petitioner was unable, through miscalculation or other circumstances, to lay off a bet. Since these were usually the undesirable bets he was more apt to lose than win upon such occasions, and therefore would gladly forego his commission in order to cover the undesirable bet with someone else.

There were several other betting commissioners in the San Francisco Bay Area, and Petitioner had working arrangements with them whereby they traded wagers when necessary to balance the two sides of a transaction. Betting commissioners [5] in this area followed a universal practice of handling all transactions in cash. Petitioner normally collected losses in cash and paid winners in cash. Most of his business was handled by word-of-mouth, usually over the telephone, and cash settlements were made following the happening of an event.

Transactions with other brokers were usually settled at periodic intervals or when the amount reached a certain fixed sum in favor of one party or the other. Comparatively little money was actu-

ally posted with the Petitioner prior to the happening of the event, which determined the wager. Settlements with out-of-city brokers were generally made by check. Petitioner usually sent his own checks, although occasionally other brokers required Cashiers Checks.

Petitioner maintained a daily revolving fund of about $3,000 in cash. Checks received were deposited in the bank or cashed depending upon the needs of the revolving fund and the amount of cash required to pay off local bettors at the time. The amount of the bank deposits and checks cashed does not reflect the gross volume of Petitioner's business or his gross income therefrom.

In order to expedite this hearing, we have entered into a stipulation at the request of the Respondent showing the Petitioner's bank deposits for the years in question and a large number of checks which Petitioner received from others and cashed. In this connection, we simply point out that the [6] stipulation does not purport to reflect the gross volume of business handled by Petitioner.

As stated before, Petitioner did not make the full 5% on all wagers. He also suffered occasional losses by being unable to collect from the losers. However, if you assume that he made a full 5% commission on all transactions and suffered no losses whatsoever, his reported income for the three years in question would have required him to handle a much greater volume of money than the amounts set forth in the stipulation.

The Respondent's deficiency letter purports to de-

termine that the total amount deposited in the bank and the total amount of the checks cashed constituted income. In our opinion as soon as the evidence discloses that the amounts set forth in the deficiency letter are in fact a portion of gross receipts, the presumption in favor of the Respondent's determination is dispelled. However, we expect to affirmatively prove that the income tax returns correctly reflect Petitioner's net income. We expect to do this in four ways:

First, the method of ascertaining gross and net income employed by Petitioner's accountant reflected Petitioner's taxable income. For several years prior to the time that he went to the Kingston Club, Petitioner had employed a certified public accountant to keep his books and prepare his income tax returns. This accountant, whose name is Mr. [7] Calegari, kept a set of books which covered a partnership between Petitioner and his brother and kept a record of Petitioner's investments outside of the Kingston Club. As far as we know, Respondent has raised no issue concerning any of the records kept or work performed by Mr. Calegari.

At the time Petitioner went with Mr. Coplin, Mr. Coplin had an accountant by the name of Murton. Mr. Murton went to the Kingston Club at least every month and took off the records of the income and disbursements of the card room. He also collected daily memorandum sheets upon which the Petitioner had noted daily cash expenditures. He also took the bank statements and canceled checks

and reconciled the bank statement with the check book stubs. Mr. Murton consistently kept the bank statements, checks and other memoranda either at his home or his office. They were not kept at the Kingston Club as were the books of account of the card room.

Mr. Murton arrived at Petitioner's gross income at the end of each year by subtracting the amount in the bank at the beginning of the year from the amount in the bank at the end of the year. He disregarded the $3,000 revolving fund on the theory that it remained approximately the same throughout the period. He added to the net increase or decrease in the bank balance all of the expenses of the business and all of the withdrawals made by or for the Petitioner. The result was combined with the records of the card room and constituted the [8] Petitioner's gross income. From this Mr. Murton would deduct the Petitioner's deductible expenses. Annual summary sheets prepared by Mr. Murton were then given to Mr. Calegari, who used them in connection with the other records in his own office in the preparation of Petitioner's income tax returns.

The sole issue in this case is whether or not Petitioner actually reported all of his gross income. Mr. Murton's method of reporting income was necessitated by the impracticability of maintaining records of income and disbursements which could be seized by law enforcement officers. Unfortunately, Mr. Murton is dead. We have been able to locate the

bank account and canceled checks for the last eleven months of the year 1950, but although we have made a diligent effort, we have been unable to find any other bank statements, canceled checks or memoranda pertaining to the other years involved here. The method followed by Mr. Murton was consistent throughout the years and did reflect the Petitioner's actual income.

Second, Petitioner's 1948 and 1949 income tax returns were audited by Mr. Perenti, an Internal Revenue Agent, just a few months prior to the levy of the jeopardy assessment in this matter. Mr. Perenti made no objections to the method of accounting employed by Mr. Murton. Perhaps I should mention here that when Mr. Cohen took over the Kingston Club he asked Mr. Murton if the method of reporting income was adequate and [9] Mr. Murton replied that he had a letter from the Internal Revenue office in San Francisco stating that the method employed by Mr. Murton, of reporting income, was acceptable to that office. Mr. Perenti issued a Revenue Agent's Report which we will offer into evidence and which shows several adjustments to Petitioner's income tax returns but does not question the adequacy nor the honesty of the method of accounting employed by Mr. Murton.

Third, at our request Mr. Calegari has prepared a detailed net worth statement based upon all available documentary evidence. Like Mr. Murton, Mr. Calegari has disregarded the $3,000 cash revolving fund, which is not established by any documentary evidence. The Petitioner's net worth at the begin-

ning and end of each of the taxable years involved here is consistent with the income reported on his income tax returns.

Fourth, the Petitioner's expenditures, standard of living and personal withdrawals are consistent with the withdrawals shown upon his income tax returns. His expenditures and living expenses were modest and well within the income disclosed by his tax returns. Upon the presentation of this evidence, we feel that we shall not only have dispelled any presumption in favor of the Commissioner's determination, but will have affirmatively established that this Petitioner correctly reported his income for the years in question. [10]

The Court: Mr. Sherwood, as I gather it—and I am not talking in terms of amounts or comparison with the return—you do agree that the Petitioner had income from the Knigston Club and also income acting as a betting commissioner, whatever the amounts may be? Do I understand that as far as the return itself was concerned, that there was no segregation as between the two, with respect to gross income deductions, and so forth?

I understand that there was a separate set of books for the Kingston Club, but I am talking about the return itself.

Mr. Sherwood: I think that is correct, as far as the return is concerned. However, the summary sheets which Mr. Murton furnished to Calegari, who made the returns, are available and they do have the segregation.

The Court: Do I infer from your opening state-

ment that you also maintain that the Kingston Club and the activities as betting commissioners were the only income producing activities of this Petitioner other than perhaps income from investments?

Mr. Sherwood: Yes, sir; the financial statement which we will submit has all the sources, but as I recall it, the income outside of this came from securities and a partnership with his brother, but the respondent has not questioned in any way the adequacy of those records which were kept by Mr. Calegari in his own office. The only income which has any [11] pertinency here, which is in issue, would be from the Kingston Club.

The Court: From the Kingston Club? I thought that was the income that you said was clear and acceptable and it was the betting commissioner's income?

Mr. Sherwood: In his records he used Kingston Club to describe both activities. For clarification I have tried to use the word "card room" and "betting commissioner" which were combined.

The Court: I think that is a convenient way to put it.

Mr. Sherwood: There is no question about the card room, your Honor. We have those records here and I think they were examined by the Revenue Agents, by Mr. Perenti, at least. As far as I know, there is no controversy about them.

The Court: It is your position that there is no problem about the card room but there is about the betting commissioner, and there is also no problem about income from investments?

Mr. Sherwood: I think that is correct. I think counsel will agree with that.

The Court: I will no doubt hear his views. I wanted to get your position clear in my own mind first.

Very well, Mr. Nyquist?

Mr. Nyquist: I have a brief statement, your Honor. [12]

Opening Statement on Behalf of Respondent

Mr. Nyquist: It is shown by stipulations that during the years 1948, 1949 and 1950, and prior thereto, Lesly Cohen was engaged in various activities, among others, as a bookmaker and betting commissioner in San Francisco and elsewhere. He filed his returns on the cash basis.

About the end of 1950 taxpayer's returns for 1948 and 1949 were investigated by a Revenue Agent and Mr. Perenti. This was a routine investigation. Mr. Perenti never saw the taxpayer's books of account. He worked from certain work sheets that were furnished to him and he made test checks to determine whether certain expenditures were proper. He disallowed certain expenditures; he prepared a report which the Petitioners say they will introduce in evidence, and the taxpayer stipulated to the deficiency shown thereon and paid those amounts.

Later in 1952, Revenue Agent Glenn Adrian was assigned to the case of this taxpayer. Mr. Adrian had more information to work with than Mr. Perenti did because Mr. Adrian had photostatic copies of checks that had been received from various collection districts throughout the United States, show-

ing payments made to Lesly Cohen. Mr. Adrian made a number of attempts to get access to the taxpayer's books and records so that he could check to determine whether these checks had in any way been taken into account in the taxpayer's records. He was told by [13] an accountant and others that the taxpayer's books and the records were in the hands of his attorney. When Mr. Adrian talked to the attorney, the attorney said he would consider letting Mr. Adrian see the books and records.

After a lapse of a few weeks when Mr. Adrian again approached the attorney, the attorney stated that he had considered the matter and was not going to give Mr. Adrian access to these books. In the petition, the Petitioner makes the statement that the Respondent arbitrarily disregarded the Petitioner's books and records. The plain fact of the matter is that Respondents made repeated efforts to get access to Petitioner's books and records and was denied such access. Whether the denial was arbitrary or whether it was for some good reason is not important.

The point is that Respondent was denied that access. Respondent did not in any way arbitrarily disregard the books. Mr. Perenti then proceeded to check as best he could from third party records. This involved going to the bank where Mr. Cohen had his business checking account. I misspoke myself. I used the word "Perenti" when I meant Revenue Agent Adrian was denied access to these books and he had to check from third party records. He went to the bank. He found the bank records showing deposits. He found deposit tags which showed

the amounts of checks deposited and the bank from which they came. He found bank statements which showed the amount of [14] checks written on the accounts.

The information that the bank did not disclose was either the name of the parties who issued the checks that were deposited in the bank nor the parties to whom payments were made nor the nature of the payments that went out of the bank, but by having photostatic copies of many checks payable to Mr. Cohen, Mr. Adrian was able, by comparing the dates on which the checks were shown by the bank stamps, by comparing these with the information on the deposit tag, he was able to determine which of these checks were deposited in the bank account and which were not.

Over this three-year period, Mr. Adrian discovered checks totalling a little over a quarter of a million dollars that were cashed without going into the bank. The deposits in the bank account during the same three-year period before this Court exceed a million dollars. How many other checks there are that were not deposited we have no way of knowing. We know the checks discovered total over a quarter of a million. That information is largely contained in the stipulation of facts and it will not be necessary to take the Court's time in preparing that item by item. It is in summary form.

Being denied access to the taxpayer's books and records, Mr. Adrian had no choice but to add to the income reported on the taxpayer's return these huge amounts of bank deposits and cashed checks that

he found that were far in [15] excess of any amount shown as assets on the return.

Respondent has not disallowed any deductions claimed by Petitioner on the return. Petitioner now apparently contends that there are payouts which would offset these receipts. As to whether such payoffs existed, or the amounts thereof, we will have to see what evidence can be produced. Petitioners have shown Respondent no evidence, no records of any such payoff, and Respondent did not, in the course of its investigation, find any evidence which would substantiate any payouts.

The Court: Are these payouts alleged to have been cash?

Mr. Sherwood: Is that addressed to me, your Honor?

The Court: I am just asking.

Mr. Sherwood: The bulk of the business was in cash. As counsel said, probably there are more checks than the ones he had.

The Court: I understand. I am not asking for argument at the moment, but Mr. Nyquist has made certain statements. I wanted to pin it down in my own mind because I would think, rather obviously, if they had been in a form substantially other than cash, assuming there were payouts, that some evidence would have been available. I will await the development of the evidence before I get the picture. I just wanted to get it as clear as I could at the moment, where we stood. [16]

Mr. Sherwood: The bulk of the payouts were in

cash. I think I said in my opening statement that he made out of town by check locally in cash.

The Court: Mr. Nyquist will insert the word "allege" in front of "payouts" and we will go on from there.

Mr. Nyquist: As I say, Mr. Adrian was forced to do the best he could with the information available. He found information that definitely showed that Lesly Cohen received the money. He added them to the income reported on the return. He had no information that would justify the allowance of any additional deductions that were not claimed on the returns. He was told that the Petitioner had books and records.

It was to be expected that if the Petitioner had these records he would, when the proper time came, substantiate these payoffs. Mr. Sherwood has stated that he expects to introduce evidence of the Petitioner's net worth. In other words, use a net worth method of computation to show what the Petitioner's income was over this period. Respondent, when the time comes, will offer objection to such proof for the reason that it is irrelevant.

It is irrelevant for two reasons. One, when the Petitioner—pardon me—the Internal Revenue Code of 1939 provides that when the Petitioner fails to maintain and keep adequate books and records, it is the Respondent, the Commissioner, who has a right to select a method of computing [17] income. It is not the Petitioner's right to select a net worth method of computing his income.

Secondly, the net worth method of accounting as

employed here, where the Petitioner is doing a lot of cash business, has large amounts on hand, is a method which would mean practically taking the Petitioner's word for cash on hand, which in substance, is almost the same thing as taking his word for his income. It is no stronger proof than Petitioner's own statements, just as his offering on the income items themselves.

The Court: Mr. Nyquist, just one question. In your statement you have added to Mr. Cohen's alleged activity, that of bookmaker; is that advisedly? You expect to introduce proof that in addition to operating the so-called Kingston Club card room and as betting commissioner, that he also was a bookmaker?

Mr. Nyquist: Your Honor, I do not intend to offer any proof on that particular point, for the reason that it is covered by the pleadings. Paragraph 7(a) of Respondent's answer states:

> "The Petitioner during the years 1949 to 1950, inclusive, and prior thereto, was engaged in various business activities, i.e., as a bookmaker and betting commissioner in the City of San Francisco and elsewhere."

That allegation in Respondent's answer is not denied [18] in the reply, and therefore, under the Tax Court's Rules of Procedure, stands admitted.

The Court: It stands admitted provided the pleadings to that extent are offered in evidence or a motion is made to be admitted. The presentation

of the case is up to you but I don't understand the pleadings are in evidence unless offered.

However, that is a matter for later consideration. It is hardly part of an opening statement anyhow. I just wanted to get my mind clear on what you were alleging. Your method of proof is up to you.

Mr. Nyquist: I am relying on Rule 18(b) of the Tax Court Rules.

The Court: Proceed, Mr. Sherwood.

Mr. Sherwood: I would like to call Mr. Calegari, your Honor.

Whereupon,

ADOLPH CALEGARI

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Please state your name and address for the record.

The Witness: My name is Adolph A. Calegari. My office is at 619 Mission Street, San Francisco.

Direct Examination

By Mr. Sherwood:

Q. What is your business or profession?

A. Certified public accountant.

Q. How long have you been a certified public accountant? A. Twenty-five years.

Q. And how long have you practiced your profession in San Francisco?

A. I have had my own office since 1932, 24 years.

(Testimony of Adolph Calegari.)

Q. Are you acquainted with Petitioner in this case, Lesly Cohen? A. Yes.

Q. How long have you known Mr. Cohen?

A. I have known Mr. Cohen for twenty years.

Q. Have you had occasion to render professional services to him? A. Yes, I have.

Q. And over what period of time have you rendered professional services to Mr. Cohen?

A. Approximately 15 years.

Q. And would you state what those services consist of?

A. My services consisted of maintaining a set of books for his investments, for his stocks and bonds, and in compiling that information, together with the information supplied by Mr. Cohen and—by his accountant on his Kingston Club operations [20] and preparing his federal and state of California tax returns.

Q. In connection with investments, is there also a partnership to which you rendered professional services?

A. That is right; there is a partnership that Les Cohen has with his brother Herbert.

Q. What is the nature of the partnership?

A. A joint venture that owns stocks, principally stock.

Q. Who keeps the books of that joint venture?

A. The books are kept in my office.

Q. If I understand you correctly, all of Mr. Cohen's investments and transactions are handled in your office except matters in connection with the

(Testimony of Adolph Calegari.)

Kingston Club? A. That is right.

Q. And what type of material did you receive to be used in connection with the preparation of income tax returns from the Kingston Club operation?

A. The data that I received from the accountant for the Kingston Club was in the nature of a profit and loss statement and a balance sheet at the end of each year.

Q. I will hand you this document, Mr. Calegari, and ask if you know what it is?

A. This is a statement on the George T. Murton Audit Company letterhead indicating the balance sheet as of December 31, 1949, and a profit and loss statement for the year 1948.

Q. I believe you just handed me that statement the other [21] day in my office, did you not? It was in your possession, was it not?

A. It was in the possession of Mr. Lewis. It had been originally in my possession.

Q. And how did it come into your possession?

A. I believe it was mailed to my office by the office of Mr. Murton.

Q. And did you use that document for any purpose after you received it?

A. I used it in order to prepare the tax return for Mr. Cohen for the year 1948.

Q. I show you this document, Mr. Calegari, and ask you if you know what that is?

A. This is a balance sheet prepared on the letterhead of the George T. Murton Audit Company, as

(Testimony of Adolph Calegari.)

of December 31, 1949, and attached to it is a profit and loss statement on the Kingston Club for the year 1949.

Q. Was that document in your possession?

A. Yes.

Q. Can you state how it came into your possession?

A. I received it by mail from the office of the George T. Murton Audit Company.

Q. After you received it did you use it for any purpose?

A. I used it in order to prepare the 1949 tax return of Lesly Cohen. [22]

Q. I will show you this document and ask you if you know what that is?

A. This is a handwritten statement of the income and expenses for the year 1950.

Q. Income and expenses of what?

A. Of the Kingston Club, and at the bottom is a summary of the financial position at the beginning and the end of 1950.

Q. And was that document in your possession?

A. Yes; it was.

Q. And how did you receive it?

A. I received it in the mail from the office of the George T. Murton Audit Company.

Q. Did you have occasion to use it?

A. I used it in the preparation of Mr. Cohen's 1950 tax return.

Mr. Sherwood: If the Court please, the document the witness has just identified is in handwrit-

(Testimony of Adolph Calegari.)

ing, and I believe it is the handwriting of Mr. Murton. I am going to have one of Mr. Murton's assistants, a man who worked for him part of the period, who will be here this afternoon. He can identify the handwriting. But I thought for the convenience of the Court it might be more convenient to substitute a typewritten copy, which is more legible.

Is there any objection, Mr. Nyquist?

Mr. Nyquist: I am not stipulating that in evidence [23] at the moment anyhow.

The Court: It is a problem of substitution. We can take care of that. As I understand it, it is not offered in evidence at the moment.

Q. (By Mr. Sherwood): Is there a segregation on the annual reports that you have just identified, Mr. Calegari, whereby the income and expense of the cardroom are segregated from the betting commissioner's business? A. There is.

Mr. Nyquist: Objection, your Honor. The document speaks for itself.

Mr. Sherwood: I wanted to explore a little of the method of accounting.

The Court: The paper isn't in evidence yet. I don't get the object of the particular question asked.

Mr. Sherwood: I will withdraw the question at this time. Counsel is probably right, except the terminology used is not the same terminology as the ones we have been using in court in all cases.

The Court: Mr. Nyquist, in order to go along,

(Testimony of Adolph Calegari.)

do you have any objection to these questions subject to their being followed up by proof and admission of this particular document?

Mr. Nyquist: Yes, I do, your Honor. I don't see that; this witness did not prepare these documents, didn't see the [24] books and records. He merely copied something off these documents onto the returns; therefore, I don't think that this witness can in any way identify these documents in any way that will substantiate the returns.

The Court: If there are any expressions of particular use in the type of business in which the taxpayer was engaged, wouldn't it be helpful to have some explanation of that terminology?

Mr. Nyquist: If they are explanations of terminology I have no objection.

Q. (By Mr. Sherwood): I call your attention, Mr. Calegari, to the fact that on the 1948 sheet there is terminology used here of "cards" and "horses." On the 1949 statement there is a statement, "bankroll (cards)" and one for "horses." On the 1950 return there is a column entitled "cards" and one entitled "events."

Just as a matter of clarification—perhaps there will be no objection to asking a leading question—as I understand it, under "cards" refers to the cardroom in all cases, the card activities?

A. That is my understanding.

Q. But "horses" also embraces all athletic events. It wasn't intended to apply just to horses

(Testimony of Adolph Calegari.)

but to all the activities of the Petitioner outside the cardroom?

A. That is my understanding. [25]

Q. And the expenses which are set forth on these sheets evidence the fact that is a fact, expenses are expenses of the betting commissioner's business?

A. That is my understanding.

Mr. Sherwood: Your Honor, I would like to offer in evidence the sheets for the year 1948, which the witness has identified as being the summary which he used in the preparation of the income tax return, and it is my understanding the income tax returns are in evidence by stipulation.

Mr. Nyquist: They are not in as yet, but I will be glad to put the stipulation in at any time.

Mr. Sherwood: Suppose I withdraw this for a moment. We have the stipulation, but I thought it had been filed.

The Court: Let's put the stipulation in. Is there anything that I need to read in it that hasn't been covered in the opening statement?

Mr. Nyquist: I don't believe so, your Honor.

The Court: As I gather it, after this is offered, if counsel wanted a brief intermission this morning —that having been received—if counsel wants to, we will take a recess for ten minutes.

(Short recess taken.)

The Court: On the record.

Mr. Sherwood: Counsel is willing to stipulate that a copy of the Revenue Agent's report, which

(Testimony of Adolph Calegari.)

is identified as the [26] examining officer, R. Perenti, may be offered and received in evidence.

Mr. Nyquist: No objection.

The Court: Very well.

The Clerk: Exhibit 6.

(The document referred to was marked and received in evidence as Petitioner's Exhibit 6.)

Mr. Sherwood: I would like to offer the statement as of December 31, 1948, which this witness has identified and testified that he used in connection with the income tax return in evidence as Petitioner's Exhibit next in order.

Mr. Nyquist: Objection, your Honor. There is no proper foundation laid. It has been referred to as a summary, but no showing of what it is a summary. This witness did not prepare the summary; this witness merely copied it on the schedule of the return and it carries no more weight, and is nothing more than a Schedule C on the return itself.

Mr. Sherwood: But it is part of the work papers of the man who prepared the return. I think the weight of the evidence is something else. We will have to perhaps bring out various sources from which this data was compiled, but I think the document is relevant anyway.

The Court: What makes the work papers of the man who prepared the return relevant unless a foundation is laid for the work papers? [27]

Mr. Sherwood: He has stated that this summary was given to him by the accountant.

(Testimony of Adolph Calegari.)

The Court: He said the accountant mailed it to him, as I understand it, but he hadn't said what the accountant's sources were, and it is my understanding that it purports to comprise the income from both the cardroom and the betting commissioner's activities, and the only books and records that purport to be in the room relate solely to the cardroom.

Mr. Sherwood: That is correct, your Honor, as far as it goes. However, I can ask the witness this question also. He knows, I believe, Mr. Murton is dead.

Q. (By Mr. Sherwood): Is that right?

A. Mr. Murton is dead.

Q. I believe he died in 1950?

A. I am not sure.

Q. Were you employed by Mr. Lewis, counsel for the Petitioner, to make an independent examination of the available records, bank accounts and so forth, of the Kingston Club following Mr. Murton's death? A. Yes; I was.

Q. And what bank records were you able to find?

A. I was able to find the cancelled checks and bank statements beginning with the month of February, 1950, through December of 1950. [28]

Q. Were you able to locate any data for the month of January, 1950?

A. I was able to obtain a copy of the bank statement for January of 1950, from the bank.

Q. What did you do in connection with the bank statement and cancelled checks for the year 1950?

A. I prepared a summary indicating the dis-

(Testimony of Adolph Calegari.)

bursements made from that account month by month for the year 1950.

Q. And did that disbursement include disbursements for both the cardroom and the betting commission business?

A. My understanding is that there was just one bank account, and I presumed that the disbursements made from it were for both departments.

Q. Were any of the data which you had in your possession indicating the payment of bets?

Mr. Nyquist: Calling for a conclusion of the witness, your Honor, and I object.

The Court: I will sustain the objection, Mr. Sherwood. You have asked this witness whether something or other indicates certain things to him. We don't have in evidence what he is talking about. We don't have any foundation as to how or why they indicate anything to him. He examined some bank statements. I don't know whether the bank statements are in the stipulation or not, but I don't know of any particular basis for this witness' inferences from them. Are they in the [29] stipulation?

Mr. Lewis: No, your Honor.

Mr. Sherwood: Only the deposits. However, I can go ahead and clear that up.

The Court: Respondent's objection is sustained.

Q. (By Mr. Sherwood): Do you have an analysis in your work papers, Mr. Calegari, showing the disposition of funds that were in the bank during the year 1950? A. Yes; I do.

(Testimony of Adolph Calegari.)

Q. Would you state just in general for us what these sheets are? You have shown us three sheets.

A. The heading is "Lesly Cohen, disbursements, checks, Kingston Club, 1950," and it is headed up with a total and then each of the months, January through December.

Mr. Sherwood: Mr. Nyquist, we furnished Mr. Adrian with photostatic copies of these sheets. You probably have them.

Mr. Nyquist: I recognize that sheet.

Q. (By Mr. Sherwood): Proceed.

A. On it is listed the person or organization to whom the checks were made payable, and the amount of the disbursements, the amount of the checks month by month, which would ultimately be the total—which was totalled. After I completed the summary [30] I conferred with Mr. Cohen and he indicated to me which ones were in payment of bets. I then prepared a summary of the information that is on these sheets, which formed the basis for one of the schedules on the report that I prepared.

Mr. Nyquist: There is one point I would like to clarify. You stated you gave Mr. Adrian a copy of this schedule, and I stated yes, but I wish to clarify the point that this was not done prior to the issuance of the 90-day letter.

Mr. Lewis: That is right; it was done subsequently. All the information furnished was after the 90-day letter.

The Court: All right; proceed.

Q. (By Mr. Sherwood): Did you make a simi-

(Testimony of Adolph Calegari.)

lar analysis of the bank account for the year 1949?

A. I did not.

Q. Did you make a similar analysis for the year 1948? A. I did not.

Q. Can you state why not?

A. There were no cancelled checks, no check stubs or bank statements available to me for those years.

Q. Did you make an effort to look at them?

A. Yes.

Q. What did you do?

A. I conferred first of all with the attorney, John Lewis, and also with Lesly Cohen and also with the office of [31] Murton.

Q. Who was in Murton's office after Mr. Murton died?

A. A Mr. Ebje, certified public accountant.

Q. Did you ask Mr. Evje if he knew where the bank statements were?

A. Yes; I did. He indicated that there were records stored——

Mr. Nyquist: Objection, your Honor, hearsay testimony.

The Court: Let the answer, "Yes; I did," in and strike out the balance of the answer.

Q. (By Mr. Sherwood): And did you make any inquiry of anyone else other than those that you have mentioned?

A. Yes; I did. There is an accountant here in San Francisco, a certified public accountant, who took over a portion of Mr. Murton's practice, and

(Testimony of Adolph Calegari.)

some of Mr. Murton's records were believed to have been in his possession.

The Court: Mr. Sherwood, why are we going into this? Suppose he did inquire of a number of certified public accountants or anybody else. Where does that place his testimony; what does that add to the case?

Mr. Sherwood: I am just trying to establish, your Honor, that we made diligent effort to get the same data for preceding years that we actually have for 1950. We were unable [32] to do it because of Mr. Murton's death.

The Court: Does counsel for the respondent question that an effort was made to get this information?

Mr. Nyquist: Your Honor, we are not in a position to stipulate anything about the effort made. The petition states that the taxpayer kept complete books and records showing these transactions, and we are consequently not going to enter any stipulation to that effect.

The Court: He is just being asked whether he made inquiries; as I understand it, there is no objection to him being asked that, so go ahead.

The Witness: The man's name is William J. Ker, Certified Public Accountant, 1095 Market Street. Mr. Ker indicated that after a search of his records he was——

Mr. Nyquist: Objection, your Honor.

The Court: Strike out from the words, "Mr. Ker indicated" on to the end of the answer, and

(Testimony of Adolph Calegari.)

will you, Mr. Calegari, please answer the precise question asked? If there is anything further to be asked, Mr. Sherwood will ask it and don't volunteer information.

Q. (By Mr. Sherwood): Did you in fact receive any information from any of the people that you have just stated that you talked to concerning the bank account, cancelled checks for the years 1948, 1949? A. I did not. [33]

Q. In looking at page one of your work papers, I notice a red letter "B" appearing frequently down the page. Can you state what that means?

A. Those indicate the disbursements for bets.

Q. And are the other things identified as to what the disbursements were for, those that are not marked with "B"?

A. The rest are indicated from the payee, the expenses indicated by the party to whom the disbursements were made, like the telephone.

Mr. Nyquist: Your Honor, I will not object to this testimony, but this is a conclusion of this witness who prepared those papers. I don't quite see that it is going to add much, but if he is trying to prove he had information, I want him to show the source of that information. If it is just his conclusion, I wish you would make that clear.

The Court: As I understand it, the schedule isn't in evidence yet?

Mr. Sherwood: That is right.

The Court: It hasn't been offered. This witness is explaining, as I understand it, his own symbols

(Testimony of Adolph Calegari.)

and he hasn't explained why he used those symbols, or what basis, if any, supports them. Do you have any different view of that, Mr. Sherwood?

Mr. Sherwood: He did testify that he discussed the matter with the petitioner. [34]

The Court: He testified that he discussed the matter with the petitioner, but he didn't testify, and over objection, he couldn't testify what the petitioner told him. If petitioner is going to take the stand and identify the items it is a different proposition.

Mr. Sherwood: In view of the fact, your Honor, that the testimony now shows that Mr. Murton is dead, these records were kept by him, these sheets were furnished by him to Mr. Calegari for the purpose of using them in the tax returns, and that they were in fact so used, and the returns are in evidence, I would like to renew my offer that the document which is entitled "Kingston Club, December 31, 1948," be admitted into evidence.

Mr. Nyquist: I would like to renew my objection. It is a document that purports to be a summary without any foundation being laid for the summary. It proves nothing more than Schedule C in the return itself. It is merely a copy of Schedule C.

The Court: I have heard nothing yet, Mr. Sherwood, which would indicate what Mr. Murton's basis was for his papers. My understanding, again, is that the only books and records in this courtroom have to do with the cardroom, and as to that I

(Testimony of Adolph Calegari.)

gather from you there isn't any dispute anyhow. What Mr. Murton's basis was for his schedule with respect to the income from Petitioner's activities as betting commissioner is not [35] before us, as far as I know. This purports to be a summary made up by an accountant who is now dead, but what he made it up from, and the authentication of what he made it up from, and the basis for his summary is not before us, as far as I can see.

I will have to sustain the objection.

Mr. Sherwood: Well, your Honor, will realize that we are placed in a very difficult position by reason of Mr. Murton's death, but we will do what we can this afternoon with Mr. Evje.

The Court: All I can say, Mr. Sherwood, is I am sure you will do your best, but the Court must have the satisfaction of knowing that the Court didn't put you in the position you are in. I have to rule on matters as they are presented.

Q. (By Mr. Sherwood): Mr. Calegari, were you employed by the attorneys for the petitioner to make an audit of all Mr. Lesly Cohen's affairs for the years 1948, '49 and '50? A. Yes; I was.

Q. And did you in fact make such an audit?

A. I prepared a report.

Q. And upon what information or data was that report based?

A. Insofar as Mr. Cohen's assets, liabilities [36] and income and expenses were concerned, with the exclusion of the Kingston Club matter, I have com-

(Testimony of Adolph Calegari.)

plete and thorough records substantiating everything that I have in my report.

Q. Where are those records kept?

A. In my office.

Q. And by whom were they kept?

A. By one of my assistants.

Q. Proceed.

A. As far as the Kingston Club matter is concerned, the information that is presented in my report was taken from the summary sheets which are already subscribed, together with the analysis of the disbursements from the bank account for the year 1950.

Q. Did you take into account any cash which was not evidenced by any documentary proof?

A. I did not. There was no way for me to know the amount of the cash on hand either at the beginning or the end of any particular period. The amounts had apparently been disregarded by the accountant Murton, and in the interests of being consistent, I also ignored them.

Q. Is this the report which you prepared?

A. Yes; it is.

Q. I call your attention to Exhibit A attached to it, or included in the report, and ask you what that is?

A. Exhibit A is a summary of Mr. Lesly Cohen's net worth [37] for the period from January 1, 1948, to December 31, 1950.

Q. Is there included in that summary of his net

(Testimony of Adolph Calegari.)

worth, the interest that he has in the partnership with his brother that you described awhile ago?

A. That is also included.

Q. And the securities which he owns, are they included? A. That is right.

Q. As I understand you, then, aside from any investment in the Kingston Club, you have in your own office the records upon which the net worth statement is based? A. That is right.

Q. And you have kept those records for approximately how many years?

A. Ten or fifteen.

Q. Calling your attention to the year 1950, I will ask you if the schedule pertaining to the operation of the Kingston Club in 1950 is the same as the summary which you received from Mr. Murton, or whether you made any changes or adjustments in it?

A. It is not the same. I discovered several items of a personal nature which had been considered as expenses and which I eliminated in arriving at a smaller loss than that indicated by Mr. Murton's figures.

Q. Did you discover those items through the analysis of the bank account that you just [38] described? A. I did.

Q. Was there an adjustment also for income taxes paid on the deficiency on the Perenti report?

A. That was one of the items that had been overlooked as a personal withdrawal rather than as an expense in that year.

Q. And what is the effect of that adjustment

(Testimony of Adolph Calegari.)

that you made on the amount of loss shown on the tax return?

A. Mr. Murton's original figures showed a loss of some $26,000. The adjustments that I found reduced the loss by $9,800.

Q. You have included in this report separate schedules for the partnership account referred to, have you? A. Yes; I have.

Q. And also the individual investment account of Mr. Cohen? A. That is right.

Mr. Sherwood: I would like to offer this report. Counsel has been furnished with a copy of it.

Q. (By Mr. Sherwood): Did you furnish it, Mr. Calegari? A. Mr. Lewis did.

Mr. Nyquist: Objection, your Honor. This report is largely the conclusion of this witness. It is based, to a large extent, upon the documents which in themselves under the Court's previous ruling, were excluded from evidence, and from [39] Mr. Murton's sheets which form a basis for part of this and has been shown by Petitioner's own testimony to be inaccurate, and it does not purport to be any summary of any books and records. It is unsupported by this witness, and to a very great extent——

Mr. Sherwood: I will have to take exception to that statement, your Honor. The biggest part of this report——

Mr. Nyquist: I shouldn't say it is nothing but unsupported; I should say it is to a large extent unsupported conclusions of this witness, and to the

(Testimony of Adolph Calegari.)

extent that it relates to the items in controversy, it is unsupported conclusions of this witness. The items not in controversy, I think he has documentary evidence to support.

Mr. Sherwood: I might say, your Honor, of course, this was suggested by counsel's opening statement this morning concerning the net worth. As I indicated, we believe that the net worth of the Petitioner as shown by record, for which there is no question, they are in the hands of the certified public accountant, are corroboration of our general position.

I am not taking the position that we are entitled to prove the man's income by net worth. I am not raising that, but it is corroboration.

The Court: Mr. Sherwood, let's get to the point at issue. In the first place, in his objection, Mr. Nyquist does not mention any objection to the net worth basis and subject [40] to any argument he may have later, it would be my tentative view, at any rate, that you had every right to offer a net worth computation, if it were properly supported as an indication of the correctness or incorrectness of your position.

It doesn't mean that you are reporting to the net worth basis. It is a matter of evidence, but that is not before us now. This witness has produced a report. The report is worth nothing unless the basis for the report is established in the record or is here and available, subject to analysis, and while all

(Testimony of Adolph Calegari.)

this data which the witness may have in his own office may be highly satisfactory to him, I haven't heard a word as to what it is or whether it would be satisfactory to me.

There isn't the slightest indication that any material part of this report which covers anything that is in dispute is supported by anything in this room or by any evidence which is in the record or by the stipulation, so far as I know. The mere fact that a report is gotten up by a certified public accountant doesn't, as far as I know, give it any particular standing, any particular sanctity or make it admissible in evidence.

As I understand, Mr. Nyquist's objection is that substantially this report taken as a whole is unsupported as far as the record is concerned, up to the present time, and that is my impression, too, and subject to anything that you have to say, at this point I would sustain the objection. [41]

Mr. Sherwood: There is no question but what some portions of the report are based upon the Murton summaries because that is all there were, but the biggest part of this report is made up of schedules prepared by Mr. Calegari from his own record which he keeps.

The Court: He kept his own records and no doubt will continue to keep them, but where did he get them in the first place? I don't know.

Mr. Sherwood: I might ask him that.

Q. (By Mr. Sherwood): Showing you Exhibit B(5) on this report, which has a list of stocks on

(Testimony of Adolph Calegari.)

this sheet, this purports to have a list of stocks, the date acquired, the number of shares and the cost.

The Court: Is that particular schedule in issue?

Mr. Nyquist: I don't see where it really comes into issue. I haven't checked the accuracy but I don't see the materiality.

The Court: As I understand it, that part of the case is not in issue.

Mr. Sherwood: It is part of his net worth. I thought we should establish that.

The Court: It is part of his net worth, and as far as I am concerned, if you can build a complete net worth from this witness' testimony, and that of a dozen others, it is all right with me, but a net worth statement with one item proved, [42] or five items proved out of fifty—and I am using that as an example—is not a net worth statement by any means.

Mr. Sherwood: True, but I can only prove one thing at a time, and I would like to go as far as I can.

The Court: But you are offering this one report at the moment. Perhaps you can go ahead on this one schedule.

Q. (By Mr. Sherwood): The schedule at the bottom shows a total value of $88,568.17. Do you find that?

A. That is the total amount of the cost of the stocks that are owned by the joint venture of Lesly Cohen and his brother, Herbert A. Cohen.

Q. What we want to know is upon what did you

(Testimony of Adolph Calegari.)

base this Schedule B(5)? Where did you get the information?

A. The information from which this schedule was prepared were the broker's statements who actually had custody of the stocks.

The Court: Mr. Nyquist, can't you stipulate?

Mr. Nyquist: I have no objection to Schedule B(5).

The Court: Very well; Schedule B(5) will be received.

Mr. Sherwood: Well, Schedule B(6) then, which is an even longer list of stocks——

The Court: Why can't you run through this with Mr. Nyquist and see what schedules he is willing to accept and [43] then confine yourself to the others? It seems to me we will move faster.

Mr. Nyquist: I might say, in stipulating these schedules I will stipulate that the Petitioner owns these stocks and this witness found them. I do not thereby purport to stipulate that he owns——

The Court: You stipulate that he did own these stocks and that the cost figures are accurate?

Mr. Nyquist: Yes, your Honor.

The Court: Very well. Is there anything else in here that you can stipulate, Mr. Nyquist?

Mr. Sherwood: How about Schedule B-8, Notes Payable?

Mr. Nyquist: We have no information on that, your Honor. I don't know what it is.

Q. (By Mr. Sherwood): What information do you have on it, Mr. Calegari? Did you see the notes

(Testimony of Adolph Calegari.)

that you put out here? A. Yes; I did.

The Court: Are they in court?

Mr. Lewis: They are here; the largest one, your Honor. I think I have the others some place in the file.

The Court: I am not going to admit the schedule, Mr. Sherwood, unless the notes are in Court, subject to examination by respondent counsel.

Mr. Lewis: Your Honor, this morning you suggested you [44] wanted to leave early. I think we could take that schedule and the records here during the noon recess and probably stipulate to certain matters except what Mr. Cohen will have to testify to.

The Court: I would hope so, gentlemen. These matters are matters which normally should be taken up before the trial. I don't say that in any sense of criticism because about 80% of the time they are not taken up prior to trial, but it does seem to me that if any items can be eliminated by stipulation, that it ought to be done, and I will give counsel time to do it, within reason.

Do you want to go on with this witness for about ten minutes longer or do you think you could use your time better otherwise, Mr. Sherwood? I will leave it to you.

Mr. Sherwood: I think, in view of our conversation this morning, for a little longer noon recess we would just as well adjourn now, if it is agreeable with the Court.

The Court: As far as I know, I won't be able

(Testimony of Adolph Calegari.)
to get back until about 2:00 o'clock. If counsel and the witnesses are here, and I get back earlier, I will be ready to proceed.

But, Mr. Sherwood, I am not ruling on anything because I don't have anything before me at the moment, but I have tried to indicate my policy as a guide to you, either in making objections or perhaps using other means to get your evidence in, but broadly speaking, and subject to whatever may develop, [45] I can't permit this witness to testify to summaries of unsubstantiated facts. You have got to have a basis for them before he can testify to them. The mere fact that he has some certified public accountant and a summary or statement, or the mere fact that he has got some record of his own, unless they are here and are proved to be proper, the mere fact that he is an accountant and makes some calculations, doesn't make his evidence admissible.

We might just as well face that and get down to the problem of proving what can be proved in the case. Again I am just talking broadly, to give you the advantage of being forewarned about it so that you can proceed as well as circumstances permit, to get the basis for your evidence, but I certainly don't intend to merely accept in evidence something which purports to be a certified public accountant's analysis simply because a certified public accountant made the analysis. He can only make it on the basis of something, and that something has to be in evi-

(Testimony of Adolph Calegari.)

dence, or here and of a nature which makes it appropriately subject to a summary.

If it is anything more—if anything needs clarification I will be glad to do it, but I am sure you know the rules better than I do, and I have no doubt you know the case better than I do. If there is anything further you want to inquire about I will be glad to listen to you, otherwise we will recess until 2:00 o'clock or a short time prior to that, if I [46] can return ahead of that hour.

Mr. Sherwood: We will be here shortly before that, your Honor, in case you should return.

The Court: Try to stipulate whatever you can, gentlemen. Let's confine this to what the real issues are.

(Whereupon, a recess was taken until 2:00 p.m.) [47]

After Recess

(Court met, pursuant to the taking of the recess, at 2:00 o'clock p.m.)

The Court: Proceed.

Mr. Sherwood: If the Court please, we had some discussion this morning of Mr. Calegari's report, and I have asked the clerk to mark Petitioner's Exhibit 7 for Identification.

The Court: Very well.

Mr. Sherwood: We have tried to follow the Court's suggestion before the recess, and clarify as many of these things as we can. Of the schedules

which are included in Petitioner's Exhibit 7 for Identification, Respondent has no objection to the following schedules:

B-1, B-2, B-3, B-4, B-5, B-6, B-8, B-9, C-1, C-2—strike out C-1—C-2, C-3, C-4.

The Court: They will be received.

(The document referred to was marked and received in evidence as Petitioner's Exhibit 7.)

Mr. Nyquist: That is correct, your Honor. Respondent has no objection in the sense that Respondent agrees that those schedules list assets and so forth owned by the Petitioner. We do not contend thereby that these necessarily reflect all of the assets of the type listed.

The Court: That will be numbered Exhibit 7, as one [48] exhibit.

Mr. Sherwood: Of course, it is my purpose by another witness to identify, lay a foundation for the other exhibits, and I hope eventually we can offer the whole exhibit as one exhibit without tearing it to pieces.

The Court: You can withhold it at this time, but we will understand that while it has been merely marked for identification, that the schedules with respect to which Respondent has no objection, will be received into evidence.

Mr. Sherwood: Thank you, your Honor. We have in court the bank statements for the year 1950, and the checks for the year 1950, except for the month of January. These have been exhibited to counsel and those that are shown on the witness'

report with a red "B" are now being examined by the Revenue Agent.

Counsel is making no objection to the admission into evidence of the three pages which the witness has identified as being Lesly Cohen distribution checks, Kingston Club, 1950; photostatic copies of these sheets were furnished to the Revenue Agent some months ago.

Mr. Nyquist: We have no objection to that schedule as a summary of the checks, with this qualification: That we are not stipulating to the identification placed on there by the witness which are in payment of bets. I request that it be understood that in stipulating to this schedule, we are not [49] stipulating to any of those initials or designations placed on there by the witness.

The Court: As I understand it, the figures and the written data are admitted except for the witness' inferences or conclusions or interpretations.

Mr. Nyquist: Yes; they are the marks which the witness used to designate what he thought were in payment of bets.

Mr. Sherwood: That is satisfactory. We will identify those checks by another witness.

The Court: Very well; subject to qualifications mentioned, that is received.

The Clerk: Exhibit 8.

(The document referred to was marked and received in evidence as Petitioner's Exhibit 8.)

Mr. Sherwood: You may cross-examine.

Whereupon,

ADOLPH CALEGARI

having previously been duly sworn, resumed the stand and testified further as follows:

Cross-Examination

By Mr. Nyquist:

Q. Mr. Calegari, you prepared the income tax returns of the Petitioner, Lesly Cohen, for the three years involved before this Court? [50]

A. Yes; I did.

Q. Did you, in the preparation of those income tax returns, see any complete books of account in respect to all transactions of the Kingston Club?

A. I did not.

Q. Did you see any books of account?

A. Yes; I did.

Q. Do you have such books of account?

A. They are not in the courtroom today.

Q. Books of account of the Kingston Club?

A. No; you asked if I had seen books of account.

Q. Did you see any books of account of the Kingston Club? A. No; I did not.

Q. Did you ever see any books reflecting betting transactions? A. No; I did not.

Q. When you were shown this document which is marked Exhibit 7 for Identification, you stated that you had information supporting the various figures shown on Exhibit A in that document. Do you have Exhibit A before you so you can see what I refer to? A. Yes, sir.

(Testimony of Adolph Calegari.)

Q. On Exhibit A, I call your attention to a line where you say, "Deduct personal expenses to balance year, 1948, [51] $10,578.11."

Do you have any documentation for that figure?

A. No, sir. I can explain, if you like, how I arrived at it.

Q. Was that figure arrived at by a basis of an inference on your part? Is that a figure that is based on inferences on your part?

A. No; that represents the difference between his net worth at the beginning of the year and the end of the year, after taking into consideration income after taxes.

Q. And that is the figure that is necessary to put in there to make it balance; is that right?

A. That is right.

Q. And is the same true of the corresponding figures, "Personal expenses to balance year, 1949," and "Personal expenses to balance year, 1950"?

A. That is right.

Q. Calling your attention to Exhibit C, was that schedule prepared by you for the purpose of showing Mr. Cohen's taxable income for this year, or these years? A. That is right.

Q. And now calling your attention to a deduction at the bottom of that page, "additional federal and California income taxes, years 1948 and 1949," which you show in the amount of $12,209.10? [52]

A. That is right.

Q. Why do you show that as a deduction in the year ending December 31, 1950?

(Testimony of Adolph Calegari.)

A. Well, because I indicate that as a liability at the end of 1950 so in order for it to appear as a liability it has to be a reduction of his income.

Q. Was that amount paid in 1950?

A. It was paid in 1951.

Q. Was this taxpayer on a cash basis?

A. Yes, he was. If I may add a comment there, I indicate in my report just what I have said, and the reason.

Q. Turning to Exhibit B, in the year 1950 you show at the bottom of the schedule, two amounts, one due to the Collector of Internal Revenue, and one due to the franchise tax commissioner, one in the amount of $11,108.75; one in the amount of $1,100.35.

Are those the same amounts we are talking about?

A. That is right; that is where I show the liability.

Q. And those amounts were not paid in the year 1950? A. They were not.

Q. They were liabilities that were not paid?

A. That is right.

Q. And yet this schedule was prepared for the purpose of computing the income of a cash basis taxpayer?

A. It is indicated on there simply to indicate there was [53] that indebtedness against that year's income.

Q. Then your figures don't purport to represent Lesly Cohen's taxable income for that year?

A. The taxes due the Collector of Internal Rev-

(Testimony of Adolph Calegari.)

enue aren't a deduction anyway, from a tax standpoint.

Q. But you place them on there as a liability?

A. I wanted to indicate on the statement that the examination had been made and that the taxes were due. It is purely a matter of convenience and I have indicated that on my report. I can refer you to it.

Q. That answers my question.

A. Thank you.

Q. Mr. Calegari, on the third page of your report you have a statement, and I quote:

"Based on the accounting method used, it follows that any decrease in expenses automatically decreases the receipts." A. That is right.

Q. Are you referring to an accounting method that you used?

A. No; the accounting method that I refer to is the method that was used on the Kingston Club record.

Q. It is a method that you understood was used on the Kingston Club records?

A. That is right.

Q. You did not maintain those records? [54]

A. No.

Q. And you did not see those records?

A. I saw the summaries only.

Q. This statement is not based upon your personal knowledge but upon your conclusion that you have reached, based on information that reached you? A. Based on information supplied me.

(Testimony of Adolph Calegari.)

Mr. Nyquist: I have no further questions of this witness, your Honor.

Mr. Sherwood: We might wish to call Mr. Calegari later, but I think we will have to lay additional foundation before doing so.

The Court: Mr. Sherwood, I, of course, can't tell until you ask to bring him back, but I realize this is a complicated case, and my inclination will be to give every reasonable opportunity to see that justice is done.

Mr. Sherwood: We will excuse you for this time, Mr. Calegari.

(Witness excused.)

Mr. Sherwood: Mr. Evje.

Whereupon,

ARNOLD W. EVJE

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Please state your name and your address for [55] the record.

The Witness: Arnold W. Evje, 110 Sutter Street, San Francisco.

Direct Examination

By Mr. Sherwood:

Q. What is your profession or occupation?

A. Certified Public Accountant.

(Testimony of Arnold W. Evje.)

Q. How long have you been a CPA?

A. Since 1949.

Q. And are you engaged in practice at this time?

A. I am.

Q. By yourself? A. No; in partnership.

Q. Were you acquainted with the late Mr. Murton? A. Yes; I was.

Q. In what connection did you become acquainted?

A. I worked for Mr. Murton from December 1, 1946, through approximately November 30, 1950.

Q. What, in general, did your duties consist of in that employment?

A. All types of accounting, income tax returns, general accounting business.

Q. Were you given access to all his records and accounts? A. Yes.

Q. Do you recall how Mr. Murton's health was in 1949 and [56] 1950?

A. Well, in 1950 he had a heart attack, I believe, just about March, and was out for approximately eight months from the office, or seven months.

Q. Who normally handled the accounting for the Kingston Club? A. Mr. Murton.

Q. During this period of eight months when he was out, who handled the accounting?

A. I handled the accounting for, I think, four months.

Q. And did you have any pattern or information, any format to follow?

A. I followed the work of Mr. Murton, his past

(Testimony of Arnold W. Evje.)

working papers, and if there were any questions, I imagine I asked him for a particular answer.

Q. You had access to the papers for a period prior to the time he had the heart attack?

A. That is right.

Q. And would you state what you did in the way of keeping records for the Kingston Club during the period which you personally kept them?

A. Well, I have some information here which would indicate the type of work that was done. It consisted basically of two types of record, one listing the operation, presumably, of the cardroom as such, prepared by Mr. Elbert Wright, which [57] would list his salary and minor incidental expenses. Those were taken from a day book——

Q. These have not been introduced in evidence, Mr. Evje, but these are the books I referred to in my opening statement as being in Court.

Will you proceed, please?

A. Yes. The other information, or summary, monthly summary was prepared from the check stubs and bank statement and cancelled checks and consisted of simply posting under suitable headings all deductible expenditures and any drawings that might have been made by Mr. Cohen. These in turn were posted to what Mr. Murton called a general ledger sheet maintained on columnar paper and were footed at the end of each month and proven across to tie into the total amount of recorded disbursements for the Kingston Club, based on purely business deductions.

(Testimony of Arnold W. Evje.)

In addition to that, each month, for the four months at least that I did the work, I reconciled the bank, merely taking again the balance, adding it to the total deposits for the month, subtracting the disbursements for the month and recording any outstanding deposits or checks with no regard as to whom paid or what for, or anything like that.

Q. Did you have any records of cash expenditures in addition to the ones shown by checks?

A. Yes; a daily—I shouldn't say a daily. I believe it [58] was a monthly sheet that was given, listing all of the expenditures for the month pertinent to either cash drawings, cash expenditures or checks. These were either attached with a rubber band or in some manner, with the bills that were paid, not necessarily all of the paid bills, but all of those for which Mr. Cohen had receipts. Those were basically the start for posting these expenses which were checked to the cancelled checks to the bank and to the check stubs.

Q. Did you have in your possession any original records of receipts? A. No, sir.

Q. Did the books which you referred to as the ledger, purport to cover receipts?

A. No; it did not.

Q. Could you tell us what further accounting procedures were carried on after those monthly postings were made?

A. The monthly postings, as I say, were recapped with a running balance month by month, so that all of the items, the particular items of rent

(Testimony of Arnold W. Evje.)

or miscellaneous expense or newspapers totals for each of those categories would add to the total amount of expenditures as record in what, as I say, is called the general ledger.

Q. And was any disposition made of those at the end of the year? A. Of which? [59]

Q. This running account, was it brought to a culmination?

A. It was brought to a culmination in a summary of income and expense which was, I believe, presented to Mr. Calegari for income tax purposes.

Q. Are you familiar with Mr. Murton's handwriting? A. Reasonably.

Q. I will show you a sheet which is marked "Kingston Club, 1950," concerning which Mr. Calegari testified this morning, and ask you if that is in Mr. Murton's handwriting? A. Yes; it is.

Q. I have here two other sheets; one is marked "Kingston Club, December 31, 1948," and one marked "Kingston Club, December 31, 1949." I call your attention to the fact that on the 1948 sheet the word "cars" and "horses" appear. On the 1950 sheet the word "cars" and "events" appear.

Can you tell us what parts, if any, of the business were intended to be designated by those two words?

A. To the best of my knowledge, the category of "cards" concerned the operations emanating from this social club or the card games as such.

Q. And there were, as far as you know, complete records kept of the social club?

A. That is right.

(Testimony of Arnold W. Evje.)

Q. Or the card game. And at the time you did the work you took off the figures, both income and expense, from those [60] records each month?

A. I did.

Q. Referring to the ledger which you have before you concerning which you have just testified, are the amounts of expense which are set forth in these three statements derived from that ledger record which you have?

Mr. Nyquist: I object to the designation "the ledger record." The document has not been identified as the ledger or record. It looks to me like an accountant's work sheet. I think the document would be properly identified.

Mr. Sherwood: I will withdraw the question, your Honor. I believe Mr. Evje did say this is what they had for a ledger.

Q. (By Mr. Sherwood): Would you allow me to take that and have it marked for identification?

A. Yes.

The Clerk: Exhibit 9 for Identification.

(The document referred to was marked Petitioner's Exhibit 9 for Identification.)

Mr. Sherwood: The top sheet, 1951, we are not offering that. It just happened to be part of the books.

Mr. Nyquist: I would like to find out a little more about what this is before I agree to it. It seems to be a lot of work sheets. I would like to find

(Testimony of Arnold W. Evje.)

out who kept it and a [61] little more of the background of what this purports to be.

The Court: Do you object to Mr. Nyquist questioning the witness at this point?

Mr. Sherwood: No, your Honor.

Voir Dire Examination

By Mr. Nyquist:

Q. Did you prepare these sheets?

A. No; only four months or five months.

Q. And these sheets were maintained in Mr. Murton's office? A. Yes.

Q. Where have they been since then?

A. I don't know. I saw them a day or two ago in Mr. Lewis' office, but I don't know where they had been.

Q. You say you posted these sheets, made entries on these sheets for a period of a few months?

A. Five months in 1950 only.

Q. You made entries relating to expenses?

A. That is right.

Q. This purports to be merely a summary of expenditures?

A. That is right; only business expenditures in the sense that you and I think of them.

Q. And it was prepared from what information?

A. From a monthly summary sheet prepared by Mr. Cohen, supported by either paid bills or the actual cancelled checks [62] working into the check stubs in his check book.

(Testimony of Arnold W. Evje.)

Q. Do you have any of these monthly summary sheets? A. No; I do not.

Mr. Nyquist: Your Honor, we really haven't disallowed any of these expenditures. I am not too convinced about this but I don't think it is material enough to be worth objecting to. I will offer no objection.

The Court: Very well.

Mr. Sherwood: One other question.

Q. (By Mr. Sherwood): For the years in question here, the entries which are not in your handwriting are in Mr. Murton's handwriting, are they not?

A. For the years in question, that is right.

The Court: Very well; no objection. They will be received.

The Clerk: Exhibit 9.

(The document marked Exhibit 9 for Identification was received in evidence.)

The Court: As I understand it, the top sheet is not applicable here?

Mr. Sherwood: That is right; the top sheet applies to the year 1951 and is not applicable.

Mr. Nyquist: These were shown to us today for the first time. We have not had an opportunity to go through them [63] carefully and in stipulating to this it is my understanding that we are stipulating to a summary of the expenditures that were on the return and were allowed; is that the understanding, Mr. Sherwood?

(Testimony of Arnold W. Evje.)

The Court: You are stipulating it into the evidence; you are not admitting the truth, as I understand it, or, rather, you are not objecting to its coming into the evidence?

Mr. Nyquist: We are not objecting to its coming into the evidence based upon this assumption: We have had no opportunity to go through it and analyze it in detail. We are taking it upon the representation that it is a summary of the expenditures that were on the return.

Mr. Sherwood: That was the question, if you will recall, I asked and withdrew, because I did not have this foundation. I am going to ask the witness if the summaries are not taken from there. That is my understanding, yes.

The Court: Well, of course, I want you to ask this witness anything you want, but in order to expedite this case, since there is no objection, but since counsel hasn't had the opportunity to examine them, can't we receive it subject to check, with the understanding that respondent will be protected, if given the opportunity to show anything that isn't correct about it even though it might be necessary to reopen the case for it, not that I assume that, but if not, then I would like to have these papers turned over to respondent counsel so he [64] can have one of the agents examine or verify it in whatever way may be appropriate.

Mr. Nyquist: Let me put it this way: We have not disallowed any of the expenses claimed. If this document contains nothing but a list of the ex-

(Testimony of Arnold W. Evje.)

penses claimed, we have no objection. If there is some other information in there other than merely a list of the expenses claimed on the returns, we do not intend to stipulate to any such other information.

The Court: Is there anything in there that isn't an expense which has been allowed, as far as you know?

The Witness: No, your Honor.

Mr. Nyquist: Very well, your Honor.

The Court: On that assurance, as I understand it, you have no objection. If you find something seriously out of line on that I will have to consider it, if, as and when it is presented. I do think, Mr. Nyquist, that if you have somebody to do it, that ought to be done today.

Mr. Nyquist: I think, your Honor, that we ought to have had an opportunity long ago to do this.

The Court: Probably so but we are faced with the situation confronting us here and not what should have been.

Q. (By Mr. Sherwood): Along the line of the discussion that has just taken place, as far as you know, the expenses set forth in the three summary sheets which were furnished to Mr. Calegari, are the [65] same expenses as set forth in the exhibit that has just been admitted?

A. That is right.

Mr. Sherwood: If they are different, your Honor, we don't know about it.

Q. (By Mr. Sherwood): This summary sheet

(Testimony of Arnold W. Evje.)

also contains a statement, a profit and loss statement, and can you tell us the method used in arriving at the profit and loss shown on these summaries?

A. The method used to arrive at what we will say is net income was to take—we had already itemized all deductible expenses. We take the beginning bank balance and subtract it from the ending bank balance, adding to that any personal withdrawals, all of these expenses as itemized, and the difference between the beginning and the ending were these adjustments which would constitute gross income. From this would be deducted this summary as submitted in evidence here to arrive at net income from the operations of the Kingston Club.

Q. Did it take into account any sums of cash that might have been on hand in the Petitioner's possession?

A. As far as I know, it would only incidentally, with reference to a particular fund or revolving fund, but other than that I couldn't say, actually.

Q. The revolving fund was more or less a permanent account in the business, wasn't it? [66]

A. That is right.

Q. But you didn't show that on any of these statements? A. No, sir.

Q. Do you recall an audit of the years 1948 and 1949 conducted by Mr. R. Perenti? A. I do.

Q. And I will show you a copy of an exhibit which has already been admitted into evidence, and ask you if that is a copy of Mr. Perenti's report?

(Testimony of Arnold W. Evje.)

The Court: It has been admitted as such.

Mr. Sherwood: I want to ask him some questions, your Honor.

The Witness: To the best of my memory it is, yes.

Q. (By Mr. Sherwood): On the front page it says, "All information was received from Mr. A. Evje, Murton Audit Company's taxpayer's representative."

You are the one who discussed these matters with Mr. Perenti, were you? A. That is right.

Q. At the time you discussed these matters with Mr. Perenti were you still in Mr. Murton's office or had you left that office?

A. I am trying to remember the exact date of the audit, the time it came about. I don't know whether it was in 1950 or [67] 1951.

Q. How did you happen to discuss the matter with Mr. Perenti?

A. Mr. Cohen called me and informed me that he had been contacted for an audit of the years 1948 and 1949 and wondered if I would discuss the matter with the agent.

Q. That is the Petitioner in this case?

A. Yes.

Q. And Mr. Murton at that time was ill?

A. That is right; if it was in '50, which I believe it was, he was ill.

Q. As I understand it the report was dated January, 1951. Mr. Perenti says it was in 1950; does that accord with your memory?

(Testimony of Arnold W. Evje.)

A. I was still with Mr. Murton then.

Q. Was Mr. Murton in the office at that time?

A. No.

Q. Do you know approximately when Mr. Murton died?

A. I believe about the middle of the year, 1951.

Q. At the time you held these conferences with Mr. Perenti, were these records which are admitted in evidence as Petitioner's Exhibit No. 8 available for his examination?

A. You mean the basic data from which those were prepared?

Q. Yes. [68] A. Yes.

Q. At that time were the bank statements and bank checks for the two years, 1948 and 1949, available? A. Yes.

Q. Did Mr. Perenti have access to those?

A. Yes.

Q. Did you succeed to Mr. Murton's business upon his death? A. No.

Q. Do you know what happened to the bank checks and bank statements for the years 1948, 1949? A. No.

Q. Have you made any effort to locate them?

A. I have. I tried contacting both the widow, Mrs. Murton, and also Mendelson and Ker, whom I believe are the successors to Mr. Murton's practice.

Q. Have you been able to locate any of them?

A. No; I have not.

Q. Referring to this memorandum of cash ex-

(Testimony of Arnold W. Evje.)

penditures to which you said were usually attached to pay bills with a rubber band, or something of that sort, do you know what became of them?

A. I do not.

Q. Where did you last see them?

A. Well, at the time I was working on them, as I say, [69] there were four or five months involved, and those I believe I brought back to Mr. Murton's office, and left there with the Kingston Club working papers.

Q. These working papers or ledgers, whatever you call it, marked Petitioner's Exhibit 8, was that kept at the Kingston Club? A. No.

Q. Where was it kept?

A. At Mr. Murton's office.

Q. Outside of these records of the cardroom which Mr. Wright kept, were any of the other records of the Kingston Club or of the commission business kept at the Kingston Club?

Mr. Nyquist: Object, your Honor. This witness was not working at the Kingston Club. There has been no showing that he would have knowledge of what records were kept at the Kingston Club.

Mr. Sherwood: I can ask him that.

Q. (By Mr. Sherwood): You did go to the Kingston Club, did you? A. I did.

Q. What did you do there?

A. I did the work that I have previously described, itemizing these particular deductions and reconciling the bank and then taking the papers

(Testimony of Arnold W. Evje.)

regarding the expenditures and our own work papers back to Mr. Murton's office. [70]

Q. Were those papers then retained at his office?

A. To the best of my knowledge, yes.

Q. During the period which you had them?

A. Yes.

Q. And did you follow the same method on that that Mr. Murton had been following prior to his illness? A. That I did.

Q. You have in front of you some other papers. Are they part of the Kingston Club documents?

A. Yes.

Q. Could you tell us what they are?

A. These are the first papers I described, taken from the gray books, the records of the cardroom itself, and the bank reconciliation for the five months involved in which I was up there doing the work.

Q. That is all the material in those papers summarized and set forth in Petitioner's Exhibit No. 8?

A. That is right.

Mr. Sherwood: You may cross-examine.

Cross-Examination

By Mr. Nyquist:

Q. Did you ever see any betting records?

A. No; I did not.

Q. Did you ever see any record of cash receipts?

A. No; I did not. [71]

(Testimony of Arnold W. Evje.)

Q. Was your method of computing income based entirely upon the receipts that went into the bank?

A. To the best of my knowledge, yes, it would be.

Mr. Nyquist: No further questions.

(Witness excused.)

Mr. Sherwood: We will call Mr. Lesly Cohen now, your Honor.

Whereupon,

LESLY COHEN

the Petitioner herein, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please, for the record and your address.

The Witness: Lesly Cohen, 471-12th Avenue, San Francisco. My Las Vegas address, if necessary, is New Frontier Hotel.

Mr. Nyquist: May I ask the witness to speak a little louder, please?

The Witness: Yes, sir. Did you hear my last answer?

Mr. Nyquist: I hear you now, yes.

Direct Examination

By Mr. Sherwood:

Q. You are the Petitioner in this matter?

A. Yes.

Q. During the years 1948, 1949 and 1950, where did you [72] reside?

(Testimony of Lesly Cohen.)

A. I resided with my brothers and sisters at 471-12th Avenue, San Francisco.

Q. And how long had you resided there?

A. Up until I left San Francisco; for approximately thirty years.

Q. You were born and raised here in San Francisco? A. Yes, sir.

Q. Went to the schools in San Francisco?

A. Correct.

Q. And I take it by that fact you had a rather large acquaintanceship in San Francisco?

A. I believe so.

Q. Just briefly, will you tell us what your original occupation was in San Francisco?

A. Well, after leaving high school I went to work on the newspaper as a copy boy, and I grew up in the newspaper business.

Q. And what department of the newspaper business were you in? A. Sports department.

Q. What did you do in that connection?

A. I covered sports in general, primarily boxing and baseball.

Q. And how long did you continue on the sports staff of the Bulletin? [73]

A. I worked on the Call-Bulletin, or on the Bulletin until it was disposed of to the Call; I believe it was in 1934 or '35.

Q. What did you do after that?

A. I did freelance work and edited a couple boxing magazines, publicity work for boxing clubs, in and around San Francisco.

(Testimony of Lesly Cohen.)

Q. Then what did you do?

A. I was called into the Army.

Q. And upon your discharge from the Army what did you do?

A. After that I returned to San Francisco and after a brief period I met Mr. Coplin who was operating the Kingston Club.

Q. Will you state what you did with Mr. Coplin?

A. Mr. Coplin invited me into his business. At that time he was running a horse race commission business and he felt with my knowledge and background I could help his business to expand into sporting events. He invited me to join him as a limited partner, which I did, and which continued until his death in late 1947.

Q. During the time that you were associated with Mr. Coplin did business happen to come under an accountant?

A. I believe Mr. Murton was the accountant for the business. [74]

A. I believe Mr. Murton—was he the accountant when you first went there?

A. To the best of my knowledge, yes.

Q. How long did he remain accountant for the Kingston Club?

A. He continued with Mr. Coplin and remained with me until his death.

Q. When did you commence operation of the Kingston Club as sole proprietor?

A. Approximately January, 1948.

Q. And how long did that continue?

(Testimony of Lesly Cohen.)

A. Until the Stamp Tax was enforced; I believe that was the latter part of 1951.

Q. Did Mr. Murton continue all through the period that you were there as accountant?

A. Yes, sir.

Q. Prior to the time that you were associated with the Kingston Club, did you avail yourself of the services of an accountant?

A. I believe Mr. Calegari handled my affairs.

Q. That is Mr. Calegari, certified public accountant who testified this morning?

A. That is right.

Q. What did Mr. Calegari do for you; what services did he render? [75]

A. Computed my affairs for the year and reported my tax, put them together.

Q. Did he have access to your records of your investments? A. Yes, sir.

Q. Were you in a partnership with your brother? A. I was.

Q. What was the nature of that business?

A. It was a partnership in the stock account.

Q. And did Mr. Calegari have anything to do with that?

A. He was the auditor for both my brother and myself.

Q. Did that go back to the time prior to your going into the Kingston Club? A. Yes, sir.

Q. Who filed your income tax returns prior to the time that you went into the Kingston Club?

A. Mr. Calegari.

(Testimony of Lesly Cohen.)

Q. In other words, he always continued to file your tax returns? A. That is right.

Q. Did you give any instruction as to where he would get the information as to your Kingston Club business for the purpose of filing your income tax returns?

A. That was usually mailed to him by Mr. Murton.

Q. How did Mr. Murton happen to do that? [76]

A. By my instructions.

Q. Did Mr. Murton give you annual statements of the business of the Kingston Club?

A. Yes; he gave me a copy, too.

Q. I will show you three documents concerning which you heard Mr. Calegari testify this morning, and ask you if they are the annual statements furnished to Mr. Calegari by Mr. Murton at your request covering the calendar years 1948, 1949 and 1950? A. That is right.

Mr. Sherwood: At this time, your Honor, I would like to offer these sheets in evidence; 1948 sheet being the exhibit next in order; the 1949 next and 1950 next.

Mr. Nyquist: I renew my objection, your Honor. We have had a very good foundation laid for some of the expenses shown there which are not in dispute. With respect to the income items, that is not a summary from any books and records, merely an income account based on some sort of computation he made, based on bank balances or something. It is

(Testimony of Lesly Cohen.)

not a summary. There has been no proper foundation laid for the income portion of these statements.

Mr. Sherwood: If the Court please, we have laid what foundation there is. I think the objection goes to the weight and not to the admissibility. This is what we have and this is what was used, and if the government wants to attack the [77] sufficiency, and we have brought out here that it does not purport to include cash, which the witness will have to testify to orally, but this is what documentation there is. It was made at the time and actually used by the accountant who testified this morning that he used them.

At that time the objection was that they were not identified. Now the witness says that he had them sent to Mr. Calegari for that purpose and that he got copies of them annually.

The Court: What does that add to it?

Mr. Sherwood: Shows those were current records made by some man now deceased, and whom we can't get here, but Mr. Evje has told us the way he arrived at it.

The Court: It doesn't show the basis for them any more than was in there before.

Mr. Nyquist: I think the record is a little more complete now, your Honor, in that it definitely shows that the man who prepared them didn't have the basis for showing the income of the business, that he didn't have any income records.

Mr. Sherwood: In any event, aren't we entitled to have the record show how the man made his re-

(Testimony of Lesly Cohen.)

returns? Maybe he didn't make them correctly, but he made them.

The Court: Mr. Sherwood, if these are offered not as to the facts contained therein, but merely to show on what basis the returns were made, which might possibly—although I [78] don't see clearly how—might possibly reflect on the question of intent with respect to the fraud issue; they are offered solely to show how the returns were prepared and limited to that, I don't see any particular objection to them.

I don't gather, however, that you offer them solely for that purpose. You offer them to show, among other things, income. I don't understand that the deductions that are in dispute——

Mr. Sherwood: Counsel has said they are not in dispute.

The Court: What I can't see so far is how they are in any way proof of income. They may be evidence of the mere calculation, the details of which I don't recall too well, but which was to take cash at the end of the year, deduct cash at the beginning of the year, broadly speaking, and consider the difference between the two as gross income, and make certain other adjustments, and then deduct these various items of expense.

I am not tempted to try to repeat that fully. It may picture on paper the results of that calculation. What have you to say with respect to that, Mr. Nyquist?

Mr. Nyquist: This calculation, your Honor, is

(Testimony of Lesly Cohen.)

based on, apparently, not on any records. The man who made the calculation had no information as to the receipts or bets; it was based solely on what went into the bank, and in the absence [79] of information that all the income went into the bank, it certainly shows that the man who made that computation didn't have the necessary information to determine the receipts.

The Court: Well, Mr. Nyquist, I don't understand that you raise any question about the fact that he had the bank statements available, and whether or not his calculation was correct, that it was taken from the bank statement——

Mr. Nyquist: So far as what went into the bank is concerned, that is already stipulated, your Honor.

Mr. Sherwood: I don't believe that is quite true. If it is, why that is all we need, but I want to get in——

The Court: How about taking a look?

Mr. Sherwood: I want to get into the record, if I can, a substitute for the missing bank statements, which I just can't produce.

The Court: How about you and Mr. Nyquist getting together with the stipulation, which is right here, to see whether those figures are or are not in it?

Mr. Sherwood: They are not in the stipulation.

The Court: I understood you to suggest otherwise, Mr. Nyquist.

Mr. Nyquist: Well, I understood he was merely

(Testimony of Lesly Cohen.)

trying to show what went into the bank. In Paragraph 5 of the stipulation:

"Total deposits, Petitioner's commercial account in the [80] Market-Ellis Branch of the Anglo-California National Bank for each of the years 1948, 1949 and 1950, were in the following amounts:

"1948, $508,000; 1949, $404,000; 1950, $283,000."

Those are round figures. In the preceding paragraph, it says:

"Throughout the years 1948, 1949 and 1950, the Petitioner maintained this commercial account and attached is Exhibit 5-E, a summary of the deposits to said account during the said years prepared from the deposit slips on file with the bank, except for the month of November, 1949, for which there were no deposit slips that could be located."

The Court: Does that satisfy you, Mr. Sherwood?

Mr. Sherwood: To the extent that those things are shown by years in the stipulation, but I still think that there is evidentiary value in the papers, and I am quite aware of the various objections that can be urged, and the one your Honor has voiced, but there is still some evidence of the facts which we are unable to produce definitely because Mr. Murton is dead.

The Court: Well, gentlemen, as I view this, there is no objection to this statement with respect to the expense item. As far as the income item is concerned, it reflects the witness'—not this witness but a former witness' calculation from beginning

(Testimony of Lesly Cohen.)

and ending bank statements, beginning and ending of each year, with the other factors described in the testimony. [81]

It is certainly not evidence that that was all of this taxpayer's income because the witness frankly said he didn't know anything about cash, and I don't know whether that is or is going to be an issue in the case, but as a summary of the analysis made of income by comparison of bank statements, I think it is probably properly receivable. Otherwise the facts in here don't seem to be disputed. When I say "receivable," I am talking about admitting it into evidence. I am not talking about the weight.

There are many things that could be suggested adversely with respect to the weight of testimony, income on that basis. I think it probably does have some evidentiary value in that respect, taken in connection with the stipulation and with the testimony. I am by no means certain in that view, however, but I think it is better to have it in the evidence than out, and I will admit it subject to objection, motion to strike and argument in the brief; if I am convinced at that time that it is not admissible I am going to strike it.

I want to emphasize that to you particularly, Mr. Sherwood, so that you will not assume that I have made any final decision admitting this into evidence. If you have any further means of authenticating it or verifying it, or otherwise supporting your position, I am telling you here and now to go

(Testimony of Lesly Cohen.)

ahead with it, because there is quite a possibility that on argument and analysis I may strike it, but as well as I can see [82] and without taking far more time than would be appropriate, and incidentally, without hearing the argument of counsel and authorities on it, I can't make a final disposition of it at the moment.

If I rule it out, there will be an offer of proof and it will be there anyhow except that it would be useless, if I ultimately determine that it should be in. If I let it in, it will be there for whatever value it may have; also giving me the opportunity on motion to strike, and argument in the brief, to strike it out. But the onus is still on you, Mr. Sherwood, to the extent that you deem appropriate to support this evidence and authenticate it, in whatever way you think proper.

However, I will admit the three sheets subject to the qualifications that I have mentioned.

Mr. Nyquist: In line with your Honor's suggestion, so there can be no mistake as to the nature of our objection, I wish to make them clear to Mr. Sherwood at this time.

The Court: Yes.

Mr. Nyquist: That we are objecting to this for the reason that it is not a summary by the accountant of some books and records which are now missing, but it is conclusions by the accountant in which he used apparently two known figures to start with, opening bank balance and closing bank balance, and to that he applied a lot of judgment of

(Testimony of Lesly Cohen.)

his own in [83] determining adjustments by way of personal——

The Court: Mr. Nyquist, I am inclined to agree with you on that. It seems to me that the purpose of this statement is, one, for whatever it's worth to determine how the income tax returns were made up; you claim they are wrong anyhow.

No. 2, it summarizes on a sheet of paper, and implements what the witness testified to as far as how he calculated the income. Personally, I think it would be just as much help if we had the figures that were in the stipulation and argument in the brief which analyzed these facts, but it doesn't seem to me that allowing it in the evidence adds a great deal to that except that it is in a convenient form of summary.

Mr. Nyquist: I agree with your Honor. If the witness merely said Exhibit C and the return reflected those same conclusions, it would have said the same thing; putting in an additional document instead of the return I don't think adds any weight to the case.

The Court: Again to make it finally clear, I am admitting, subject to objection, motion to strike and argument on the briefs.

Mr. Sherwood: Thank you, your Honor. We will do our best with the testimony that we have to give further authentication. Of course, we will not lay down just because [84] your Honor admitted it provisionally.

(Testimony of Lesly Cohen.)

The Court: You understand that my comments have nothing to do with the question of weight?

Mr. Sherwood: That is right.

Q. (By Mr. Sherwood): Will you state, Mr. Cohen, what types of business you conducted at the Kingston Club in 1948, 1949 and 1950?

A. Kingston Club proper was operated as a card room, separate from the commission business which included horseracing and sports events. The basis for the horseracing and sports events was the commission business and the maximum commission on any event or any transaction was five per cent.

Q. Five per cent of the entire wager?

A. That is right.

The Court: That is both winning and losing amounts?

The Witness: That is right, your Honor. May I amend that, your Honor? In horseracing it was only on the basis of a losing transaction on the part of the bettor.

The Court: Not being an expert, maybe you better elaborate on that a little bit. I don't quite follow you on that.

The Witness: All right. Your Honor, in the case of a horserace transaction, the better places X dollars on a particular race, and if that horse loses, why, the five per cent maximum percentage is taken. On the other hand, if the [85] bettor wins, there isn't any commission.

The Court: All right.

Q. (By Mr. Sherwood): There was some discussion this morning about the difference between

(Testimony of Lesly Cohen.)

bookmaking and commission betting. I wonder if you could clear that up for us.

A. Well, my theory is that a bookmaker is one who accepts wagers and risks his own money on the result of the event. A commissioner accepts commitments and tries to fill them and he operates solely on the commission basis.

Q. Did you have occasion to bet yourself, or carry these bets?

A. I wasn't in business for that purpose.

Q. Did you ever do it?

A. Purely by accident.

Q. What sort of arrangement might present itself where you would do that?

A. Sometimes I misplaced my confidence in placing wagers, and I was stuck with them.

Q. Perhaps you could explain that a little more clearly. I think I know what you mean but I have heard you talk about it before.

A. On rare occasions I was forced to keep wagers that I had no intention at the time I received them, or made commitments to keep. I intended to dispose of them but for some [86] unforeseen reason I couldn't do it.

Q. Would you ever make financial concessions in order to dispose of them?

A. Oh, yes, naturally I had to.

Q. How did you do that?

A. There were many cases where I would have to dispose of these wagers the best way I knew how.

(Testimony of Lesly Cohen.)

In that case I turned them over to other commissioners. We would either split the commission, or in some cases I would waive my entire commission.

The Court: You don't make yourself altogether clear to me, Mr. Cohen. I understand the last part of what you said, but under those situations, which as far as I can gather you have indicated you might have to make good, was that due to the fact that after you had taken a bet as a betting commissioner, normally speaking, you would get somebody to take the other side of that bet, maybe at different odds, but sometimes you couldn't get anybody to take the bet, or the person that you got to take the bet didn't pay up and that you had to make good the full amount of the winnings of the person who placed the bet with you; is that right, and if not what is the situation?

The Witness: No; that is not correct, your Honor. The thought is that at times on rare occasions I would take a commitment and probably a profit and not be able to dispose of [87] it.

Q. (By the Court): What do you mean by "dispose of it"?

A. Either turn it over to another person who would accept it or give it to another broker.

Q. You in some way have to get both sides of a bet, or get somebody else to take the other side?

A. That is right; that is the basis of the business.

Q. Can't we get right down to A and B? A comes to you and wants to place a bet, we will say,

(Testimony of Lesly Cohen.)

on the world series, at whatever odds you are quoting as betting commissioner. He places that bet with you. Does that mean he puts up the money for his bet or do you trust him or is it sometimes one and sometimes the other?

A. Mine was perhaps 100 per cent credit business.

Q. He placed the bet, and he potentially owed, if he lost? I mean he would have to make good on his bet? That is A. After that bet was placed with you, what did you do about it to dispose of it, as you say, or balance it off, or whatever technique you used?

A. Normally the bet wasn't placed until it was filled, until the other side was taken care of, but there were occasions when I miscalculated and I was forced to hold the bet.

Q. Do you mean by that that you assured A that his bet was placed and you couldn't find somebody to take the other [88] side, or what?

A. Well, it amounted to that but that is not the actual fact.

Q. How about giving me the actual facts; I am trying to get them.

A. Usually an emergency arose whereby I couldn't reach anybody to dispose of it, whether it be on a commission basis or just to trade it off to somebody.

Q. Well, for practical purposes, at that point—I am not placing any emphasis on the word "bookmaker" but I don't know any other word to use—but

(Testimony of Lesly Cohen.)

at the moment when somebody placed a bet with you, A placed a bet with you and you could not dispose of it, you then for all practical purposes became a bookmaker with respect to that one bet?

A. That is right.

The Court: Please, Mr. Nyquist, don't let my artificial use of the word "bookmaker" crop up in any brief or argument. I am just trying to understand it, this process; that was not supposed to be an admission that this man was a bookmaker at any time. The testimony is, up to the moment at least, entirely limited to his activities as a betting commissioner, and he and I are both trying to get that through my skull. That is as far as we have gone on it.

All right.

Q. (By Mr. Sherwood): To carry out the illustration a little further, Mr. Cohen, as I understand it, if A calls you up on the telephone, and said, "I want to bet $100 on the world series," normally you did not take the bet at that time; is that correct or not? A. That is right.

Q. What did you do?

A. I would place it on file and try to find somebody to fill it.

Q. And suppose you did find somebody who was willing to bet $100, what would you do?

A. If I did not?

Q. If you did.

A. If I did, then—then A would call me for confirmation.

(Testimony of Lesly Cohen.)

Q. A would call you back for confirmation?

A. That is right.

Q. And what would you do then?

A. The bet was placed.

Q. If you had found——

A. A and B, they get together.

Q. That was the normal operation?

A. That is the normal operation.

The Court: What happened when you couldn't get someone in B's position? [90]

The Witness: That is the reason for all these large checks, your Honor. I would have to go afield and distribute them as best I knew how.

The Court: You see, Mr. Cohen, you have to recognize you know a lot more about the betting commissioner business than I do, and yet I am going to have to understand this if I am to give you a fair result.

The Witness: I am trying to——

The Court: Sometimes you got B without any trouble. Sometimes you had to, you might say, go to some group of B professionals, we will call them, and place your bet and lose some of your commission, but other times in some manner or other, you seem to have confirmed bets to A and not be able to find anybody to take them, is that right?

The Witness: No; that is not right, your Honor.

The Court: That situation never happened?

The Witness: Where I confirmed a bet without placing it, is that what you are saying?

(Testimony of Lesly Cohen.)

The Court: Where in some manner you became responsible for the bet and couldn't find someone as a counterpart.

The Witness: That came up once in awhile, yes, sir, that is right.

The Court: You would then, in essence, be betting on the other side on that occasion?

The Witness: That is right. [91]

The Court: What circumstances would result in your confirming a bet where you had to take over in that way?

The Witness: Well, the time element mainly. Some individual would call me right on top of an event and possibly he couldn't reach me back and I would feel that I could dispose of it for him.

The Court: In your experience at times you took them on thinking you could dispose of the bet and then couldn't when the time came?

The Witness: That is right.

The Court: The bets you were unable to dispose of were generally emergencies or you couldn't contact someone in time? Were those bets as a rule desirable bets?

The Witness: There wasn't any such thing as a desirable bet for me.

The Court: You just didn't desire to bet at all?

The Witness: If I did I wouldn't wait for somebody to bet me. I would bet myself.

The Court: Going back to these bets, were they desirable or undesirable?

(Testimony of Lesly Cohen.)

The Witness: Undesirable.

The Court: Would they be more apt to lose or win?

The Witness: That is hard to judge. I imagine they balance themselves out.

The Court: Let's not be too loose with that word "desirable." [92]

A desirable bet was where he got his full commission and took no risk; a somewhat less desirable one was when he took a bet and had to replace it or make an arrangement in which he either split his commission or lost his commission, but didn't have any risk, and the third, and the type that was most unsatisfactory, was when on occasion he was forced into taking a risk that he didn't want to take; is that right?

The Witness: That is right, your Honor.

Q. (By Mr. Sherwood): In San Francisco, were bets paid in cash or by check or by any other means?

A. The common practice, as far as I am concerned, was by cash.

Q. Was that the common practice among other commissioners in San Francisco?

A. Among them or with them, the commissioners?

Q. Yes, among.

A. Among the commissioners it is always by cash.

Q. By that; you mean where you traded with them or laid off a bet with them, that was a cash

(Testimony of Lesly Cohen.)

transaction? A. That is right.

Q. In the stipulation which is on file, there are a number of checks which you would endorse which came from cities all around the country. Could you tell us how you happened to have transactions of that nature? [93]

A. Well, those were transactions that were either placed with me by those individuals or which I placed with them, and we carried on a day to day business, so to speak, and our only means of paying and collecting was by check.

Q. And how did you conduct the actual transactions with them? A. By telephone.

Q. And did you have any particular custom of settling?

A. Various ways of settling. That is, as far as time was concerned. Some were financial agreements; others were weekly, monthly, some were daily.

Q. Normally, however, as I understand it, the bets in San Francisco were generally paid in cash?

A. Positively.

Q. And referring to the number of checks which you cashed in San Francisco as shown by the stipulation on file, what would become of the money that you received?

A. Well, I carried a revolving fund in the office to meet current obligations in a betting sense, and if it ever grew too high I would put it in the bank, and usually there were a lot of checks cashed by me

(Testimony of Lesly Cohen.)

in the office with no transaction; just persons asked me to cash checks.

Q. I am referring now more specifically to these checks from out of town points.

A. Out of town checks were usually deposited, unless, of [94] course I needed ready cash to meet my local obligations.

Q. For instance, if a man in San Francisco bet a thousand dollars, and you turned that bet over to a commissioner, say in Omaha, you would need the money from the man in Omaha to pay the obligation to the winner in San Francisco, if he won?

A. That is right.

Q. What would happen if this revolving fund reached more than the usual amount; you didn't have any current obligations to pay with it?

A. If it was a matter of a few hundred dollars, I didn't do anything about it. If it ran into sizeable figures, I usually put it in the bank.

Q. Did the cash which you had on hand at the beginning of 1948 and the end of 1948 show any material difference? A. No.

Q. By "material," I mean a difference of more than a few hundred dollars?

A. I would say no.

Q. Did the difference of cash include—which you had on hand at the beginning of 1949 and at the end of 1949 show any material variance?

A. No; I always kept it around the same level.

Q. And your answer would be the same for 1950? A. That is right. [95]

(Testimony of Lesly Cohen.)

Q. Are you generally familiar with the method which Mr. Murton used in arriving at your income?

A. Well, at the outset when I took over——

Q. You can answer that yes or no first, and I will ask you more questions about it.

A. Yes, sir.

Q. And did you ever discuss the adequacy of the method with Mr. Murton?

A. That was the first thing I did when I took over the business.

Q. And will you state what that conversation was?

A. He assured me that he had a letter from the local——

Mr. Nyquist: Objection, your Honor. I move that be stricken so far as it relates to a statement that Mr. Murton made about having a letter.

The Court: What is the basis of your objection, Mr. Nyquist?

Mr. Nyquist: The objection is that Mr. Murton's statement that he had a letter is hearsay.

The Court: Well, of course, it's hearsay but isn't it an exception to the hearsay rule? I would be glad to hear from both counsel. I don't mean for one minute that that statement is admitted generally, the statement that he is apparently going to make, is to be admitted generally for proving the fact of any government ruling or that the method was or wasn't [96] accurate, but this man is charged with fraud, as well as substantially additional taxes, and doesn't it reflect upon his intent as to the type of

(Testimony of Lesly Cohen.)

advice he had with respect to the preparing of his income tax returns, and isn't it discussion along those lines, with an accountant, isn't that in the nature of a verbal act on his part consistent with the business?

Mr. Nyquist: I will agree with your Honor's point there, yes.

The Court: Have you anything to add to this argument, Mr. Sherwood

Mr. Sherwood: I think your Honor hit the point. It doesn't prove the truth of whatever the fact may have been. We are trying to prove the man said it and it was part of the witness' state of mind.

The Court: And the witness relied on it?

Mr. Sherwood: Yes.

The Court: For that limited purpose, I am satisfied to admit it.

Q. (By Mr. Sherwood): Will you state the conversation? A. Will you repeat the question?

Q. Will you state the conversation that you had with Mr. Murton with respect to the method of accounting which he used to show your income?

A. At the time I took over the business from the late [97] Mr. Coplin, I met with Mr. Murton and asked his method of bookkeeping, if it were approved by the Internal Revenue office. He assured me that he had a letter from the San Francisco office of the Internal Revenue Service that his method was approved, and that it was the same method that he used during the years he acted as accountant for Mr. Coplin.

Q. Did anyone ever tell you that your method

(Testimony of Lesly Cohen.)

of accounting was not adequate to reflect your income prior to the inception of this case?

A. Nobody discussed it with me.

Q. You were in the Kingston Club when Mr. Perenti was conducting this audit and speaking to Mr. Evje?

A. Mr. Evje and Perenti were in Mr. Evje's office, I believe.

Q. Did you ask Mr. Evje to conduct the audit with Mr. Perenti? A. Yes; I did.

Q. Mr. Murton, I believe, at that time was too ill to do so?

A. I don't know the circumstances, but Mr. Evje conducted the audit with Mr. Perenti.

Q. At that time did anyone ever object to the type of record that you had?

A. Not to my knowledge.

Q. At that time your bank account and checks were [98] available? A. Yes, sir.

Q. I will show you Petitioner's Exhibit 7 for Identification and ask you if you have seen that before? A. Yes; I have.

Q. Under what circumstances did you see it?

A. It was shown to me by Mr. Calegari for the first time at a meeting with the agents, Messrs. Adrian and Dougherty.

Q. And have you gone over the various pages of that report with Mr. Calegari?

A. Yes; I scanned them.

Q. I call your attention to Exhibit A, which is

(Testimony of Lesly Cohen.)

entitled, "Lesly Cohen Summary of Net Worth, January 1, 1948-December 1, 1950."

Have you seen that summary before?

A. Yes.

Q. And have you discussed the contents with Mr. Calegari?

A. No; I can't say that I went into any discussion with him on it. I just accepted the findings.

Q. Have you looked at the other exhibits?

A. I went through them, yes.

Q. For instance, here is a list of property set forth there; is that a complete list of your assets?

A. That is right.

Q. Do you have any securities or bonds or real or [99] personal property of any kind, or I should say, did you have during the period here involved, '48, '49 and 1950 which is not set forth hereon?

A. No, sir.

Q. As far as you know, is this a full and complete statement of your assets for those years?

A. Yes, sir.

Q. And does this take into account the $3,000 revolving fund?

A. No; there is no record of the $3,000 revolving fund.

Q. It does not include that? A. No, sir.

Q. And with the exception of the $3,000, or approximately $3,000 revolving fund in cash, does this Exhibit A correctly reflect your net worth in each of the three years set forth on it?

A. Yes, sir; to the best of my knowledge.

(Testimony of Lesly Cohen.)

Mr. Sherwood: I think, your Honor, the exhibit should be admitted in toto.

The Court: Mr. Nyquist?

Mr. Nyquist: I don't think there has been a great deal added. Which other pages do you wish to offer?

Mr. Sherwood: The entire report, which is a net worth report; all of the schedules except Exhibit A are here in support of the net worth as worked out. The accountant has [100] various comments which are related by their terms to various schedules. For instance, on this page there is an explanation of B-7; here is an explanation of B-8, and so on.

The Court: Let me see Schedule A a minute.

I will hear from you, Mr. Nyquist.

Mr. Nyquist: As far as Exhibit A is concerned, that isn't a schedule of anything. It just contains some figures that the accountant admitted were more or less plugged figures to make the thing balance. The net worth figures, for what they are, are over in Exhibit B. I don't see that Exhibit A amounts to anything, other than to plug figures that the accountant put in to balance, and that is all it has been stated is, "Personal expenses to balance." I don't see that Exhibit A is admissible for any purpose.

Mr. Sherwood: I wouldn't call them a plugged figure. You have to have a balancing figure, as I understand it.

The Court: Plugged in the sense that it is char-

(Testimony of Lesly Cohen.)

acterized, which is Mr. Nyquist's objection, as far as I can see. But let's dispose of Exhibit A. Is Exhibit A any more than an analysis of a set of figures which you could put in your brief, figures that are otherwise established? Why is that evidence?

Mr. Sherwood: Well, at least it is an illustrative exhibit which summarizes in convenient form the matters which we will wish to discuss in our brief, and it is part of the [101] accountant's report. I think to some extent it is a little misleading and unfair to the accountant to tear his report up into sections. That report, in my opinion, is a very beautiful job. It is all tied in very well. If you take out one part, it isn't going to make much sense, and I think that it should be admitted for the general purpose that we have, and, of course, the weight is something entirely different.

We know your Honor has already expressed a statement to the other exhibits which have been admitted, which, of course, are repeated in here.

The Court: Other than Exhibit A, what are the exhibits that are in issue?

Mr. Nyquist: Exhibit B; that is a balance sheet. I don't know whether it is being offered as something an accountant prepared and submitted to Mr. Cohen, or the other way around. That isn't entirely clear to me.

The Court: Maybe I have this exhibit confused with some other, but is this the one where you agreed—this isn't the one where you agreed to put in B-1, B-2, B-3, and so forth, is it?

(Testimony of Lesly Cohen.)

Mr. Nyquist: Those are supporting schedules for certain groups of assets that we agreed.

Mr. Sherwood: He agreed to all of them, Exhibit 7-B, which is entitled, "Net Worth, Kingston Club."

The Court: Are any of the C schedules left out other than C-1? [102]

I think there was an objection to C-1, wasn't there?

Mr. Nyquist: Exhibit C was not, but B-1 was.

The Court: You are objecting to Exhibit A, Exhibit B?

Mr. Nyquist: Exhibit C.

The Court: Anything else?

Mr. Nyquist: One schedule back here; Exhibit B-7, I think it was.

The Court: And C-1; is that right?

Mr. Sherwood: I can't seem to find C-1.

The Court: I have it here. Summary of income and expenses of the Kingston Club.

Mr. Sherwood: That is right.

Mr. Nyquist: That is correct, your Honor; those are the ones we object to.

The Court: That is A, B, C, B-7 and C-1?

Mr. Nyquist: That is right.

The Court: I think this is a good time to take our recess and give you gentlemen a chance at the same time to go over these statements. However, I am not as familiar with this as you are. Where is the statement that this witness said he went over which shows all of his assets?

Mr. Sherwood: Those are the ones, outside of

(Testimony of Lesly Cohen.)

the one on the Kingston Club; they are all already admitted in evidence, but, of course, that B-7 is the one that—— [103]

The Court: Well, this witness went down the line with some assets, including securities and what not, and said that those were all of the assets?

Mr. Sherwood: That is right.

The Court: What schedule is that?

Mr. Nyquist: Is that Exhibit B?

Mr. Sherwood: Yes; I think so.

The Court: The reason I am asking about these, I am not going to take any more testimony until after the recess, but how this witness can glance down these items—for instance, look at the words, "Stocks (Schedule B-2)," and some figures, and say those are all of his stocks, I don't quite see.

It does refer to Schedule B-2, which I am understanding is admitted, or has been admitted without objection, so that I suppose that would take care of the stock item at any rate. But in all events, I want to be prepared to hear Mr. Nyquist's objection and any argument you may have with respect to Schedules A, B, C, B-7 and C-1, which, as I understand it, are the only schedules left out at the moment.

We better suspend for twenty minutes, until 4:00 o'clock. If anybody thinks that is too long, I will be glad to cut it down.

Mr. Sherwood: I think ten minutes is probably long enough. We have tried for a month to get together on this.

(Testimony of Lesly Cohen.)

The Court: When you are ready, then, gentlemen, not [104] later than 4:00 o'clock, notify the clerk and he will notify me and I will come in.

(Short recess taken.)

The Court: Proceed.

Mr. Sherwood: I think the comments of the accountant which were actually explanations of how he arrived at it were necessary for the understanding of it; of course, the Court understands, and we all understand, that is not evidence. The evidence is already in the record in large part. This is a summary and a very convenient method of summarizing the entire net worth of the Petitioner. The individual schedules have had supporting proof in each case, insofar as such proof is ascertainable.

In addition to that we have established the method the accountant used in arriving at the income figures by simply stating what he did, and it is in testimony and very simple. He took the bank balances, took the difference between them, all of the expenses which he could find deductible or not deductible, all the withdrawals and called all these together the gross income.

The witness has testified that while cash was not taken into account, it was a fairly constant figure which would not have varied more than a few hundred dollars. I think any objection to that goes to the credibility and not to its relevance. [105]

Mr. Nyquist: Of course, your Honor, this is a very fine and dignified looking accounting report,

(Testimony of Lesly Cohen.)
and I am afraid if it is admitted in toto, it will apparently given weight in proportion to its appearance rather than in proportion to its soundness, of the assumptions and suppositions and hypotheses upon which it is based.

Mr. Sherwood: There is nothing, from the comments of the Court today, that would lead me to believe he had fallen into that error.

The Court: The court hadn't thought he had fallen into it at the moment, but I can see Mr. Nyquist's concern about it. I see no substitution for going over this page by page and discussing it, if necessary.

On Page 1, about the only thing that I see that could be any possible objection to it is the second sentence, and part of the sentence following it, up to a colon, in which the statement is made, that "Your instructions were to submit financial statements," and so forth, indicating Mr. Cohen's net worth, and then going on to say, "The following statements and comments, in my opinion, comply with these instructions."

Do you object to that, Mr. Nyquist?

Mr. Nyquist: I think Mr. Calegari's opinion that they do comply with those instructions—I don't necessarily agree that they accomplish anything.

Mr. Sherwood: They are not proof of the fact that [106] he did or didn't comply with them. I think we will admit that, of course.

Mr. Nyquist: If they are just being submitted

(Testimony of Lesly Cohen.)

as Mr. Calegari's opinions, I don't think we have acted upon his foundation for the opinions.

The Court: You agree that Page 1 comes in subject to that condition?

Mr. Sherwood: Yes, sir.

The Court: Well, the remainder of the page seems to simply list the schedules so I see no objection to that. The same thing applies to the beginning of page two down to the word "comments." I suppose I better read that, at least in part.

Mr. Nyquist: No objection to the second page.

The Court: No objection to the second page, Mr. Nyquist?

Mr. Nyquist: All right, sir, no objection.

The Court: What about the third page?

Mr. Nyquist: I think I better object to that right now, for this reason, that it is apparently injecting a new issue into it, if that is going to be given any weight. Mr. Calegari, in his opinion, found no basis—all right; I contend it is irrelevant for that reason.

The Court: It is a negative statement. He was unable to find a basis. That doesn't mean there wasn't a basis, [107] but do you object to that sentence coming out?

Mr. Sherwood: No, your Honor.

The Court: Very well. We will strike out the sentence beginning, "I was unable to find any basis." What about the balance of that page, Mr. Nyquist? Take your time on it.

Mr. Nyquist: No objection.

(Testimony of Lesly Cohen.)

The Court: Very well. These pages don't seem to be numbered. We will turn to page four.

Mr. Nyquist: Down to B-7, no objection. Beginning with the statement about B-7, it would be subject to the same sort of objection that the schedule itself would be.

Mr. Sherwood: In other words, if Schedule B-7 were admitted, the comment would be appropriate?

The Court: Page four then, we reserve ruling on the paragraph related to Schedule B-7 until we discuss that.

How about the balance of the page?

Mr. Nyquist: No objection.

The Court: What about page five?

Mr. Nyquist: May I ask the witness a question or two on that?

The Court: Yes.

Q. (By Mr. Nyquist): On the balance sheet there are certain amounts shown as owing by you to your brother at various times. I am asking [108] you whether that information is information which you gave to the accountant or which the accountant gave to you? A. Which brother is that?

Q. Melvin.

A. That is for checks that he made out and which my brother, Melvin, turned over to Mr. Calegari.

Q. In other words, Mr. Calegari made the computation from documents?

A. From information that he received from my brother, Melvin.

(Testimony of Lesly Cohen.)

Mr. Nyquist: Your Honor, on this statement headed, "Melvin Cohen," at the top of the page, which Mr. Calegari signed, the first one is objected to as being just an unsupported conclusion of the accountant.

The Court: That is "A" on page five, the signature page?

Mr. Nyquist: Yes.

The Court: What have you to say as to that, Mr. Sherwood?

Mr. Nyquist: That is one of the very issues before this Court.

Mr. Sherwood: That "A" in parentheses?

The Court: Yes; under "Melvin Cohen (A)."

Mr. Sherwood: I think that is a comment that is not necessary for an understanding of the [109] report.

The Court: Very well, we will strike out "A," under "Melvin Cohen."

Mr. Nyquist: B and C, no objection. D, I do not quite understand. I understand that the memos have been destroyed, and I don't see how he bases a conclusion on that as to the amount.

The Court: What relevance does Melvin Cohen's balance as of January 1, 1953, have to this case anyhow?

Mr. Sherwood: We will try to find out in just a moment, your Honor, from Mr. Calegari.

Mr. Calegari's statement is that he was assuming no opening balance and on Schedule B-9 he is recording the transactions which took place in this

(Testimony of Lesly Cohen.)
period, and concerning which he personally examined all of the checks. The records prior to that time were destroyed.

The Court: We are talking about D, under Melvin Cohen. Mr. Nyquist didn't object to the part of it down to the semicolon. He says he doesn't understand the words, "However, the January 1, 1953, balance due Melvin Cohen amounted to $3,369.32."

What has that to do with the case?

Mr. Calegari: I can answer that, if I may.

The Court: You better consult with Mr. Sherwood before you do any answering.

Mr. Sherwood: I am willing to have Mr. Calegari, who [110] has been sworn, make a statement, but I can't see the relevancy of it.

The Court: I don't know whether Mr. Nyquist wants him to make it or not.

Mr. Nyquist: It is immaterial. If we strike it out, I think it is immaterial. Let's just strike it.

Mr. Sherwood: I can't see its materiality.

The Court: If neither counsel can see its materiality, then under D we strike out everything after the semicolon on the second line.

What about Schedule C-1 as referred to on page five, Mr. Nyquist?

Mr. Nyquist: I have no objection to these comments. I think they are all right, although I am not necessarily going to agree with Schedule C-1, but I have no objection to the balance of this page, your Honor.

(Testimony of Lesly Cohen.)

The Court: As I understand it, as to Items 1 through 7 you make the same reservation as you did as to B-7 on page four? That depends on whether the schedule is in or out?

Mr. Nyquist: I make no reservation on these, your Honor.

The Court: Very well. Then the balance of page five, the signature page, is admitted without objection.

Mr. Nyquist: Very well, your Honor.

The Court: Then we go to Schedule A. [111]

Mr. Nyquist: Exhibit A is objected to because it means nothing. It adds nothing to this case whatsoever. The only figures there that might have any significance are the net worth figures taken from Exhibit B. The other figures are just figures put in to balance that are not from any records of any kind.

The Court: For practical purposes then the question of admissibility of Schedule A depends on what we do with respect to Schedule B; is that right?

Mr. Nyquist: No. I have an additional objection to Schedule A. I say the only figures that have any —we have the net worth figures from Schedule B.

The Court: Yes; I am sorry. I should have said "exhibit" instead of "schedule."

Mr. Nyquist: If Exhibit B is excluded, this should be excluded for the same reason. If Exhibit B is admitted this adds nothing to it. There are statements in here about net income after taxes

(Testimony of Lesly Cohen.)

which is a conclusion, and I can see that nothing but argument results from this Exhibit A. I can't see that it sheds any light upon anything before this Court, and I therefore object to it.

The Court: We will have to reserve A until we consider B and C; is that right?

Mr. Nyquist: I think that will do for the moment, your Honor. Turning to B, I don't know exactly what we are [112] being offered here. Are we being offered a document which summarizes this witness' testimony as to his assets and liabilities or is this being offered as a summary of an audit prepared by a CPA; just what is being offered?

Mr. Sherwood: I would say, your Honor, in that regard, in the first place, it does definitely summarize the testimony of the witness. He said that he had gone over it and that to the best of his knowledge and belief it was correct. It reflected his net income and net worth for the years in question.

In addition it admittedly, by what Mr. Calegari testified to this morning, is a compilation made up from all the records in Mr. Calegari's office, plus the sheets which were received from Mr. Murton at Mr. Cohen's construction and direction. The evidentiary value of some of these items, of course, depends upon the same thing that the schedules themselves depend upon, from which they were taken. I think they should be in for what they are worth. Also because Mr. Cohen himself has testified that they are correct, and correctly represent his balance sheet as of the dates given.

(Testimony of Lesly Cohen.)

Mr. Nyquist: I wish to make two different types of objection to this. First, if it is to be taken as an expert opinion of a certified public accountant, I I object to that. This is not a summary of any records of any sort. This is merely a list. It represents this witness' views as to what [113] his assets are, and anything that the accountant has prepared there is merely on the basis of information furnished to him by this witness and should not be given any greater dignity than the testimony of this witness. It should not be dignified as being something in the nature of an audit or something by a public accountant.

With respect to this being merely a summary of the testimony of this witness, it is respondent's contention that under the decision of this Court in the case of Morris Miller, on April 29, 1955, net worth has nothing to do with this case. That was a case in which, due to absence of records, the Commissioner made a determination on the basis of bank deposits. The taxpayer objected and said net worth more accurately reflected his income and attempted to prove his net worth case, and I will read one paragraph here from the Court's opinion, if I may:

"Petitioner strongly contends that in the determination of the deficiencies, the Commission should not have used the bank deposit method but should have used the increase in net worth method.

"Petitioner concedes that the books and records which he was able to submit to the Revenue Agent

(Testimony of Lesly Cohen.)

for all of the taxable years in question, except 1947, were wholly inadequate to enable the agent to compute his net income by books and records. He contends, however, that respondent in his use of [114] the bank deposit method has greatly inflated Petitioner's net income for all of the years in question except the year 1947.

"Petitioner concedes that the Commissioner has reached about the same figure of net income for 1947 as he has reached in the use of the increase in net worth method. Section 41 of the 1939 Code provides generally that the determination of income shall be on the basis of the method of accounting regularly employed in keeping the books, but where the method employed doesn't reflect income or where proper records are not kept or are lost, the computation shall be in accordance with such method as, in the opinion of the Commissioner, does clearly reflect income." Louis Cali, 7 Tax Court 245.

"The choice as to which method of computation of income shall be applied in a situation such as this, where no books are produced or inaccurate books have been kept, rests not with the Petitioner but with the Respondent, since it is the Commissioner who is given the choice of methods by which income is to be computed where no adequate books or records are kept. We should concern ourselves initially in this case with Respondent's computation of income on the basis of bank deposits."

The Court: Well, Mr. Nyquist, that case, as I

(Testimony of Lesly Cohen.)

hear you read it—I will be glad to look at it—if you disagree with what I say—it doesn't seem to meet the point here. I [115] fully agree with what I gathered while you were reading it, that the decision says that if the books and records aren't sufficient, the Commissioner can pick and choose under Section 41, I think it is, what method he uses, but I have yet to hear anything said that the taxpayer can't in turn make the effort to rebut what the Commissioner has determined by the taxpayer's own method of computation, whatever it may be, not that the taxpayer can say the Commissioner must determine it by the net worth basis, but that if the Commissioner takes the bank deposit method or any other method, I don't see anything which says that the Petitioner can't come back and try as well as he can, by any method to rebut it.

If there is anything in that decision to the contrary, I will be glad to hear it because it is rather crucial. I mean, you get my point on that?

Mr. Nyquist: Yes, your Honor, I do. I would be inclined to agree to this extent, your Honor: If the Petitioner—I don't think the net worth could be used as a method of arriving at a figure for taxable income. I think that it is probably correct, your Honor, to say that net worth could be used as additional evidence, perhaps substantiating a figure on a return, or something like that, but I don't think the computation could be based on net worth method. I think that is substantially what this case holds.

(Testimony of Lesly Cohen.)

The Court: As to Schedule B, have you any question [116] about the liability?

Mr. Nyquist: Of course, there are certain liabilities on there that have no place in any computation for any of the years in question.

The Court: That has been explained. Liability, even though put in evidence in this way, not necessarily binding in any sense, as I understand it, certain liabilities in here which you contend should be in different years. That is the basis of your view, isn't it?

Mr. Nyquist: Yes, your Honor.

The Court: Hasn't that been explained in the testimony?

Mr. Nyquist: Yes; I think it has, your Honor. I think that the record shows that the Petitioner had these liabilities; whether he had additional liabilities in 1947, we have only his testimony. I have no way of knowing to the contrary at the moment.

The Court: Well, Mr. Sherwood, as to the assets, this witness has testified that they represent all of the assets as far as he knows. As to their being based on records in Mr. Calegari's office, we still don't know what those records are, what the source of them may be. I may have lost myself in the testimony, but I don't quite get what records of Mr. Murton's are referred to as a basis for these assets. You mentioned Mr. Murton's records and Mr. Calegari's records. [117]

Mr. Sherwood: All of the assets themselves are of record in Mr. Calegari's office.

(Testimony of Lesly Cohen.)

The Court: He said so but he hasn't produced any such records or hasn't given us the source of where he obtained them, as far as I recall.

Mr. Sherwood: It was my understanding that counsel did not question them.

Mr. Nyquist: Your Honor, in stipulating to some of these later schedules we intended to eliminate the necessity of his producing those records, insofar as these assets, as far as they are concerned, taken from these schedules a summary of the items detailed in the schedules, I think our stipulation of the schedules would cover them.

The Court: Do I understand that your only real point as to Exhibit B would be that the Petitioner can't come along and offer a net worth statement as evidence in his effort to rebut the matter?

Mr. Nyquist: That is one objection. The other is that insofar as certain items here are concerned, they are based—well, all of this is based on information furnished by the Petitioner to Mr. Calegari. Mr. Calegari has no way of knowing what other assets the Petitioner may have that are not on here. The Petitioner has testified that this is a complete financial statement, and I am willing to go along with the fact that this summarizes the testimony of this Petitioner [118] on the matter. I am not willing to have it go in with the dignity of being a result of a certified public accountant audit of books and records in the sense that—because Mr. Calegari had no way of knowing what other assets this Petitioner might have.

(Testimony of Lesly Cohen.)

The Court: Do I gather that you are satisfied with the assets listed on here, that is, their admissibility into evidence as far as they go and that your point is that it might be interpreted as meaning all the assets?

Mr. Nyquist: Yes; if it goes in as being a result of an audit here, as though the CPA knew that he had all the assets. This witness has said they are all the assets, and I am willing to agree that has been his testimony at this point, but I don't think it is a matter that has been a result of an accountant audit. It has been the result of information furnished by this witness, and I want that point to remain clear.

The Court: Let's see if we can't resolve this. Mr. Sherwood, are you willing to agree that Exhibit B be admitted into evidence subject to the understanding that there is nothing in the record other than the testimony of Mr. Cohen that the assets listed on Schedule B are all of his assets?

In other words, that Mr. Calegari, so far as the evidence shows, had no means of knowing whether Mr. Cohen had additional assets, whether cash or otherwise? [119]

Mr. Sherwood: I think that is obvious, your Honor. No one could possibly know that.

The Court: Well, without argument, and whether it is obvious or not, are you willing to have it come in with that understanding?

Mr. Sherwood: I would like to have the entire report admitted, with the exceptions which have

(Testimony of Lesly Cohen.)

already been stricken out with the understanding that the items here—in fact, all the items under "assets" on Exhibit B are actually items that can be proven one by one here in Court, if it were necessary, but after talking to counsel, he said it wasn't necessary, with the exception of that one item, entitled, "Kingston Club," and that is shown, the balance shown on the bank sheets at the beginning of the year, and that is all it is.

The Court: You are getting aside from my question. I am trying to find appropriate language to protect both sides upon it. I have no intention of admitting Schedule B as indicating that Mr. Calegari, as a certified public accountant, in some manner has been able to exclude the possibility of assets in addition to what is on that schedule.

Mr. Sherwood: We certainly agree that he could not do that.

The Court: Well, he did not.

Mr. Sherwood: He did not and could not. [120]

The Court: Very well, then. As I understand it, that removes one of your objections?

Mr. Nyquist: Yes, your Honor.

The Court: The other objection, I assume you still press, that this taxpayer has no right to produce his own net worth statement as distinct from requiring the respondent to produce a net worth statement?

Mr. Nyquist: Yes, your Honor. I might add further that where a taxpayer deals in large amounts of cash, as done here, his net worth state-

(Testimony of Lesly Cohen.)

ment of this sort is entitled to about as much weight——

The Court: That is a matter of argument, is it not?

Mr. Nyquist: Yes, your Honor.

The Court: If it is properly established by net—by any method, bank deposits or otherwise, or properly established that this man had cash, and increasing amounts of cash, from the standpoint of your burden, or if the Petitioner fails to exclude that possibility with respect to his burden of proof in overcoming the presumptive correctness of the respondent's determination of deficiency, then the net worth statement wouldn't be worth anything, but subject to what has been said and subject to motion to strike and argument on the briefs, I will admit Schedule B merely, adding the comment which seems to be agreed to by everybody up to this moment, that the only testimony in this record that these are all of [121] Mr. Cohen's assets as of the dates mentioned, is the testimony of Mr. Cohen himself.

Mr. Nyquist: Exhibit C is objected to for the same reason that the series of papers submitted by Mr. Murton were objected to in the sense that they are conclusions of Mr. Murton—wait a minute; excuse me. I misread this.

Exhibit C is objected to as being merely conclusions of Mr. Calegari that are not supported; a number of the items here, business, profits from business, are the very issue before this Court. Mr.

(Testimony of Lesly Cohen.)

Calegari's statement down here that the income is in those amounts, having never seen the books and records himself, is not entitled to be admitted or entitled to any weight in these proceedings.

The Court: What have you to say?

Mr. Sherwood: I think, your Honor, the same argument goes to the summary sheets from which they are made. Mr. Calegari did not purport to introduce anything new. He testified that he got his information from the records which are already at least provisionally in evidence. There is no difference between Exhibit C and Exhibits—whatever their numbers are—six, seven, eight and nine and ten. They are all bound up in there.

Mr. Nyquist: I agree fully with Mr. Sherwood's statement that there is no difference between this and Exhibits 7, 8, 9 and 10, and they were admitted solely for the purpose of [122] showing what the income tax return was based on, and only for that purpose. This is not admissible for that purpose.

Mr. Sherwood: I think that the record will show that there was some qualification why they were admitted. They are admitted also for the broad charge; for another thing the Court didn't limit that to the fact you mentioned. But this summary sheet, Exhibit C, represents the income we allege he got from the Kingston Club. Also the income from the partnership with Herbert A. Cohen, his interest, his deductions. As I understand it, there is no objection to the deductions. The only objection is that we are attempting, according to Mr. Nyquist,

(Testimony of Lesly Cohen.)

to dignify, the report as though it were the result of an audit, but I think that is not a correct comment, your Honor, because Mr. Calegari told us exactly what he based these figures upon.

I think the objection on all these matters goes to the weight rather than admissibility.

Mr. Nyquist: I think this adds nothing at all to what is already in the record here. It just repeatedly puts in figures that were based on some papers that were used in preparing the return, but for which no foundation was laid by merely putting them in in different places and forms. That is not adding any information that is useful to this Court.

The Court: Mr. Nyquist, subject to the view that Schedule C couldn't possibly be taken is any statement that [123] this is all of Mr. Cohen's income; this is merely the amount of it that Mr. Calegari's report sets out on the purported basis of other factors in the record.

What, if any, items of income do you maintain are not supported by the record up to the moment?

Mr. Nyquist: Well, your Honor, we know there is an awful lot of money that came in here that isn't shown somewhere. Apparently the records are not maintained by the taxpayer to show exactly where it came in, and I don't think that we can particularly point exactly where that may have been received.

I think certain of those items, the exact amount of dividend income that was found by Mr. Calegari is shown there; the exact amount of a couple other

(Testimony of Lesly Cohen.)

items of income from partnership was found by Mr. Calegari as shown there. There is a lot of money that came from somewhere that isn't shown there.

I fail to see where this summary sheet adds anything at all to the information; that is, the basic data is all in the record. If this is intended to be evidence of something other than a mere summary, it is adding nothing, and if it is intended to be a summary, it is not a particularly useful summary.

The Court: It is a convenient one, isn't it?

Mr. Nyquist: I don't believe so, your Honor.

The Court: Why not? [124]

Mr. Nyquist: Well, because insofar as some of those items are concerned, they are items that have not been established. They are the very items in dispute.

The Court: Just point out one to me. I am not disagreeing with you or agreeing. I am trying to follow you.

Mr. Nyquist: Well, of course, that Kingston Club, in particular, Mr. Calegari states quite definitely in his beginning pages, that that is not based on any books and records.

The Court: But he stated his method of ascertaining it.

Mr. Nyquist: Yes, your Honor, and when we get down to putting it in that way, his method of ascertaining it is based entirely on unsubstantiated reports which were admitted already for the limited purpose of showing what the return was prepared from and to admit those unsubstantiated reports

(Testimony of Lesly Cohen.)

again in here is adding nothing useful in this case. This is not the document that the returns were prepared from. I see no reason for putting those unsubstantiated figures in several times just to make them look stronger.

The Court: Mr. Sherwood, do you contend that Schedule C is anything more than a summary of what is already in the evidence?

Mr. Sherwood: It is a summary of these various schedules which already have been admitted. [125]

The Court: Well, it is a summary of some of the testimony as well, isn't it?

Mr. Sherwood: Yes; but I would like to correct one misapprehension. Counsel says, for example, that a profit from the business of the Kingston Club is entirely unsubstantiated. I am not in any way trying to say that the method accounted for the cash because the evidence shows that the cash was not included, but, nevertheless, the profit shown here is the profit shown by analysis of the bank accounts.

Mr. Evje stated that it was based upon that and they did not take into account any cash at all. I don't see why counsel objects to the fact that we say they made $19,750 in 1948. If he has any evidence, or if there is any evidence of any kind that Mr. Cohen made more than that, let him bring it out, but this much we have established from the bank account. Mr. Evje testified to that. They didn't grab the air and take these figures.

The objection, as I see it, from counsel's stand-

(Testimony of Lesly Cohen.)

point, is that they didn't take into account the cash, so if there were more cash than Mr. Cohen says there was, then this figure would be higher, but it wouldn't be lower. This is the amount actually in the bank, and I think we are entitled to have that in. It is a very convenient record for us to use, and if it doesn't add anything to what is already in, I can't see why it should be objected to. It is a convenience to me in writing the [126] brief and I think it would be a convenient summary for the Court to have.

The Court: There is no use going any further on it. I am rather puzzled as to the evidentiary value, if any, of Schedule C. It seems to me that it take figures that were either in other schedules or were testified to, and it simply summarizes the Petitioner's version of what his income was.

There is nothing in here, of course, at all about cash, and so far as I know, there isn't even any testimony in the case that this represents all of Mr. Cohen's income, or that anybody knows whether it does or not, but there is some evidence that there was at least this much income. I can't see my way out of the woods on this at the moment.

I am going to admit it subject to motion to strike, and argument on the brief. That brings us back to Schedule A, which is dependent upon Schedules B and C, and otherwise is substantially worthless, as far as I can see, and is nominated as a summary of net worth. I am going to admit it subject to

(Testimony of Lesly Cohen.)

motion to strike and argument on the brief in connection with Schedules B and C.

The next schedule we have to consider is B-7.

Mr. Sherwood: I think the determination on that will depend upon eventually your ruling on the motion to strike, will it not? It is just an amplification of the same item that counsel [127] objected to.

The Court: It seems to be.

Mr. Sherwood: If you strike Exhibit C, you would strike this exhibit along with it, I take it?

The Court: Well, actually, wouldn't it be if I struck Exhibit B, or, rather, Schedule B? This Schedule B-7 appears to be a balance sheet and reconciliation of net worth. It would take into consideration both Schedule B and Schedule C-1, which we haven't come to yet, but it doesn't seem to add any fact.

What is your objection to Schedule B-7, Mr. Nyquist?

Mr. Nyquist: Well, this is intended to be a balance sheet, and I don't think that has been supported by anything in the record, as to where those figures came from. I think that is my chief objection, to begin with.

The Court: Of course, this is really a subsidiary item anyhow. It purports to be only a balance sheet of the Kingston Club, and is not a complete balance sheet, or not a complete reconciliation, as I understand it.

Mr. Nyquist: My objection to the top half of

(Testimony of Lesly Cohen.)

the page is that it is a balance sheet item, unsupported by anything in the record, and my objection to the bottom part of it is that it is irrelevant and assumes certain conclusions as to the income. The conclusions are some of the very issues before this Court.

The Court: What is your view, Mr. [128] Sherwood?

Mr. Sherwood: I am not an accountant, your Honor, but it seems to me this is one of the mechanical means that the accountant uses to explain what he has done in his work. It doesn't add any new evidence. Unless the evidence in the record justifies the Court in making findings, I am sure that this wouldn't supplement the evidence, so that you could make any additional findings, but I think it is part of the accounting procedure which would be helpful to all of us, and it does not add anything, as far as income is concerned, to the evidence which we have in the record, but it shows how all these schedules were pulled together, and arrived at in the summary.

Mr. Nyquist: There is a point I would like clarified here. Mr. Sherwood says something about it, that it isn't any new evidence. It is merely either a summary or taxpayer's contention. If they are admitted to show what the taxpayer's contention is, all these exhibits, I have no particular objection to them.

I do object to a good many of them as being evidence of the facts that are reported therein.

(Testimony of Lesly Cohen.)

The Court: Mr. Sherwood, why don't the whole of B-7, why couldn't that be put in your brief?

Mr. Sherwood: I suppose if the brief writer would go around and do what Mr. Calegari did when he made it up.

The Court: I think he would. He could copy this [129] and make what references he has.

Mr. Sherwood: I can't see, with the understanding and qualifications that the Court has already put in the record, I can't see why the whole thing is not properly admissible as a statement of what the accountant found; it is tied in to all the documents we have.

The fact that it doesn't account for the cash has been testified to by all three witnesses and that should be understood. But it does purport to be perfectly complete as far as it goes, and we know what it is based upon.

The Court: What about Schedule C-1, Mr. Nyquist? I am going to rule on B-7.

Mr. Nyquist: That is the most objectionable one in the group. The first few lines in that are entirely—there has been nothing to show where those figures came from. I don't think Mr. Calegari has identified those figures in any respect.

The Court: You are talking about the receipt item?

Mr. Nyquist: I am talking about the receipt item and disbursements on bets; where he got those figures I don't know.

The Court: Mr. Sherwood?

(Testimony of Lesly Cohen.)

Mr. Sherwood: I did not ask Mr. Calegari about that. If you will recall, we reached an impasse on some other matters, but I do know what he did and I can recall him to clarify [130] it.

The Court: I suppose we better dispose of this while we can. I am going to admit Schedule B-7, subject to motion to strike and argument on the brief, and the same with respect to Schedule B-7 on page four of the preliminary statement.

You can withdraw this witness for the moment, if you wish, and put Mr. Calegari back on the stand in reference to Schedule C-1, or whatever you have in mind.

(Witness excused.)

Whereupon,

ADOLPH CALEGARI

called as a witness for and on behalf of the Petitioner, having previously been duly sworn, resumed the stand and testified further as follows:

Direct Examination

By Mr. Sherwood:

Q. Mr. Calegari, may I ask——

The Court: Just a minute. I have also ruled on Schedule A, as I understand it. I think I have ruled on everything, of course, subject to qualification, except for Schedule C-1.

Before Mr. Sherwood starts to question this witness, Mr. Nyquist, it might save time if you would

(Testimony of Adolph Calegari.)

indicate whether you have any objection to any part of Schedule C-1 except the item, "receipts, bets," and the two items of disbursements, [131] "Bets—identified," and "Bets—unidentified."

Mr. Nyquist: I have not had time to compare that but I assume that with the exception of those items at the top, that these other items repeat the items on the return which were allowed.

The Court: Very well. Go on then, subject to check. You can bring them up later, if you wish.

Q. (By Mr. Sherwood): Schedule C-1 is entitled, "Lesly Cohen, Kingston Club, Summary income and expenses, January 1, 1950-December 31, 1950."

Mr. Calegari, will you state what you did in comparing Schedule C-1 of your report?

A. Schedule C-1 has a heading, "Anglo-California National Bank Commerical Account." The item of "receipts, bets, $283,000" represents the deposits that went into that account during that period.

The Court: That is all the deposits?

The Witness: All the deposits in the commercial bank account with the Anglo-California National Bank for 1950. The item of disbursements——

The Court: Wait a minute, now. What about "Receipts—cash":

Q. (By Mr. Sherwood): Cash deposits and checks deposits; is that right? A. No. [132]

The Court: Don't lead, Mr. Sherwood. Let him answer the question. I assume he knows the figure, and the reason for it. He is testifying to it.

The Witness: The item of "cash" represents

(Testimony of Adolph Calegari.)

the receipts during that period, which were not deposited.

The Court: How do you know that? On what basis did you determine that amount of cash?

The Witness: On the basis of the difference between the receipts—no. On the basis of the difference between the bank accounts, opening and closing balances.

The Court: On that solely or did you take into consideration factors such as expenses?

The Witness: Including the expenses, and the withdrawals.

The Court: So there was a synthetic figure based on your calculation from bank statements at the beginning and end of the year with the other adjustments you discussed prior?

The Witness: That is right. The item of disbursements, bets-identified are detailed on this Exhibit No. 8 here, which is an analysis of the disbursements from that same bank account, and the items of bets are identified here, symbolized by the red "B's."

The Court: Those have not been identified yet, Mr. Sherwood.

Mr. Sherwood: I am aware of that, your Honor. I am [133] going to ask Mr. Cohen about that. I have the checks here. The witness has them in his hand, as a matter of fact, and I am going to identify them.

The Court: I may have missed what you said, but what did you say with respect to bets—identified?

(Testimony of Adolph Calegari.)

The Witness: Bets—identified are the totals of these checks that I hold in my hand.

The Court: How did you select them, and what do they show?

The Witness: The checks are made payable to various and sundry people, and I made a complete analysis of the disbursements by payee, and then Mr. Cohen instructed me as to which ones were for bets.

The Court: It looks to me, Mr. Sherwood, as if you are going to have to withdraw this witness again and do something about your bets under disbursements, but in the meantime, before you withdraw him, have you any objection, Mr. Nyquist, to these two figures of receipt bets, as far as they go; one, the total of all the checks in the Anglo-California National Bank, commercial account; and the other the cash, with the understanding of how it was determined?

Mr. Nyquist: Yes, your Honor, I do object to labeling those. I have no doubt but what Mr. Cohen had receipts and bets in those amounts, and far in excess of those amounts.

The Court: What is your objection to the fact that [134] he has at least this much?

Mr. Nyquist: Well, if it be stipulated that this simply means that he had at least this much, without any special significance being attached to this figure, but I am afraid once this figure gets in people will try to attach significance to it and say, "This is a figure of bets," and it is merely a con-

(Testimony of Adolph Calegari.)

clusion of a witness as a result of a long process of assumptions.

The Court: Mr. Sherwood, are you willing to admit at this point that there has been nothing to show that he didn't have more receipts from bets than is listed here in that commercial account and the cash item?

Mr. Sherwood: Yes; I will state that he must have had cash receipts in addition to those that went in the bank, according to the witness' own testimony.

The Court: All I am asking you—I am not asking you to admit these figures are wrong, and I am not accepting them as right, but right or wrong, from my standpoint, all I mean to say is is there any testimony in this record that for this period, January 1, 1950, to December 31, 1950, that he didn't have a total of receipts from bets more than $300,783.57?

Mr. Sherwood: I am willing to accept that, your Honor.

Mr. Nyquist: If the further proviso is that that figure for cash bets is an unsubstantiated figure. That is [135] just a conclusion of the witness.

The Court: Let's not use the word "unsubstantiated" because it requires us to do a little more work in the art of definition than I think any of us are capable of. It is perfectly clear it is a calculation based on beginning and ending bank accounts with other adjustments that have been discussed in the record and here in addition to that

(Testimony of Adolph Calegari.)

there is the statement of counsel that he agrees that up to the moment, at least, there is no testimony in the record—let's assume for purposes of illustration—and I don't know what the figure is, that you have determined that these receipts were from bets of this same period over $500,000. That is your determination. You haven't any evidence in yet.

Mr. Sherwood comes along and submits this first item and agrees that as far as his case is concerned, nobody has yet said that is the top figure, all that has been said so far is that it is at least that much; is that right?

Mr. Sherwood: That is right.

The Court: And what is your objection to it, with that explanation?

Mr. Nyquist: My objection to the figure of $17,753 is that when it was put in this bank, it looks as though it is something that has been substantiated in some sort of way, or calculated in some reasonably accurate manner. We have heard the evidence as to how he went at it; that it was some difference [136] in cash position apparently, plus certain other unexplained adjustments, and these other adjustments in there, the details of which we don't know, call for a great many conclusions on the part of the witness, and it makes that figure, nothing more than a very rough approximation and an opinion of the witness. It is not an opinion that is entitled to any weight at all.

The Court: I have your point on it. Go ahead, Mr. Sherwood.

(Testimony of Adolph Calegari.)

Mr. Sherwood: Are there any other points concerning this schedule except the one that I am going to have to call Mr. Cohen for on the bets-identified and bets-unidentified?

The Court: This witness has still not testified, as far as I know, or has anybody testified as to just how he got, just what the adjustments were and how he got them after he got finished comparing the beginning and ending deposits?

I don't know whether you want to prove it by this witness or not, and I don't know how he would know what the expense items were, but so far as I know, the record isn't clear on it.

Q. (By Mr. Sherwood): Can you state what you did in connection with the matters the Court just mentioned? A. I think so.

Q. Will you please do so? [137]

A. The items of totals on this Schedule C-1, exclusive of the bets which we have already discussed, those items of expenses are the items of——

The Court: No; that is not what we are talking about, Mr. Calegari.

The Witness: I am sorry.

The Court: We are right back to the cash items of $17,653.77. You have testified you determined that was receipts from bets on somewhat this approach. You took the bank balance at the beginning of the year, the bank balance at the end of the year, you subtracted one from the other, and you added certain items which have been very vaguely de-

(Testimony of Adolph Calegari.)

scribed as expenses of one sort or another; is that right?

The Witness: That is right.

The Court: How did you determine your additions back in getting at this $17,653.77 figure?

It may be simpler from your standpoint to start fresh and tell us how you got at the 17,653.77 figure under the title of "cash" in the first item of Schedule C-1, "receipts, bets."

The Witness: I don't know whether I will be able to explain this to your satisfaction.

The Court: That is always a hazard, but you can try.

The Witness: I actually didn't change any of the expense figures on here. Of course, the expense figures were [138] the figures used in developing the gross receipts, as I have already testified. The expenses on here are the same ones that are shown on the statements presented by Murton. So that in the development of the gross receipts, I simply added the bets-identified and the bets-unidentified to the expenses shown on the Murton statement.

That is all I have done in arriving at that $300,000 figure. I have simply added the deposit that went into the bank to the gross receipts that were on the schedules supplied by Murton.

Mr. Nyquist: If your Honor please, isn't that another way of saying that is the figure that is necessary to put in there to get up with the income shown on the return?

The Witness: That is correct. I am sorry for

(Testimony of Adolph Calegari.)

having answered that out of turn, but that is exactly what happened.

The Court: Do I get it then that the item of $300,783.57 is the total receipts shown on the return?

The Witness: No; it is not, your Honor. The deposits in the commercial account were not considered on the tax return. This was a calculation that I made as the result of the bank statements and cancelled checks for 1950, and I wanted to summarize what had happened in that account during that year. It is not necessarily a total of the receipts. It is simply a summary of what happened to that commercial account during that year. [139]

The Court: Well, it is simply what happened to the commercial account that year, but what we have to know is what did happen, and all you tell us is that you concluded a figure from what happened, but you haven't told us what happened yet. That is what we are trying to get at. You did tell us one figure. You said that this first item of $283,000-odd was simply an addition of all deposits in that account during the year.

What did you do after that?

The Witness: I also summarized the disbursements in that account for that year.

The Court: You summarized the disbursements but they could have been a number of types; in some what you seem to have segregated personal expenses, or rather, you made that kind of a closing

(Testimony of Adolph Calegari.)

figure and separated it from items of expense; is that right?

The Witness: I have a complete analysis of the disbursements here by payee.

The Court: Mr. Nyquist, can you, one of your men and Mr. Sherwood get together with Mr. Calegari and look this over, what he calls a complete analysis, which is, as far as I know, you haven't seen yet, and which may get us closer to what we are aiming at?

Mr. Nyquist: In answer to my question a moment ago, I think the witness agreed with me when I said that figure is a [140] figure——

The Court: What figure?

Mr. Nyquist: Derived by arithmetic, which is the figure necessary to produce the income shown on the return.

The Court: I understood him to say later that it wasn't the income shown on the return.

Mr. Nyquist: Net income shown on the return. The gross figure did not show on the return in this amount.

The Court: See if you can't cross-examine him a little further so it can get through my head. After all, I haven't had the opportunity to prepare this case. It is all new to me and I would like to understand that point, Mr. Nyquist, if you can bring it out a little bit clearer.

Mr. Nyquist: I don't purport to understand the taxpayer's unique method of accounting myself.

The Court: Can you consult with your confreres and tell us what is wrong with it, or haven't you had time enough to do it? I am not trying to ask you a puzzle question. I am trying to move, if we can,

(Testimony of Adolph Calegari.)

but not to hurry you. If you are not in position to answer it, all right. I don't expect the impossible.

Mr. Nyquist: No, I am not, your Honor, except that from the testimony of this witness I gather this is a figure which he calculates working backward as to the amount of cash there must have been in order to produce the income that he [141] showed; is that right?

The Witness: That is right.

The Court: You started with net income shown on the return?

The Witness: I started with Mr. Murton's statement, your Honor.

The Court: Mr. Murton's statement of what?

The Witness: Of the income and expenses for that year.

The Court: And we have never had the basis of Mr. Murton's statement. I have forgotten for the moment, but what is the status of Mr. Murton's statement, as far as the evidence is concerned?

Mr. Nyquist: Mr. Murton's statement was admitted for the purpose of showing that the return was based on that——

The Court: Merely showing how the return was prepared.

Mr. Nyquist: And there were assumptions in there, and this witness is piling assumption upon assumptions.

Mr. Sherwood: Mr. Evje testified as to the method by which Mr. Murton arrived at his summary, and whatever criticism might be made of the

(Testimony of Adolph Calegari.)
method, there should be no doubt upon this record as to how he did it.

Mr. Nyquist: Nobody is questioning that, but you are passing on, it seems to me, Mr. Sherwood, from a question [142] of how the return was prepared to the question of what was income, and there are two very different things. I am not at the moment able to take the leap with you. I am trying to find out if we can take it or not, but there are two different things there.

Mr. Nyquist: I might also point out too, your Honor, that Mr. Murton's summaries were admitted for the purpose of proving how the return was prepared. Now Mr. Sherwood says that Mr. Evje explained how Mr. Murton did it, as if that fortified Mr. Murton's conclusion.

All Mr. Evje did was to explain the general method of approach. There was not enough detail or explanation to determine the accuracy or correctness of Mr. Murton's work in any respect, and this witness himself, to the extent he has found records, has found Mr. Murton's work was inaccurate.

Mr. Sherwood: I will take exception to that last statement. There is substantial agreement between the work that Mr.——

The Court: Well, there are a few minor changes; they don't amount to a great deal in a case of this type, but what it seems to me is happening at the moment, is that these statements made by Mr. Murton were admitted for the sole purpose of showing how the return was made out, certain collateral evidence with respect to the question, possible ques-

(Testimony of Adolph Calegari.)

tion of this taxpayer's intent. The present witness seems to [143] be using Mr. Murton's figures as a starting point for income, and it is my understanding that they haven't been admitted for that purpose, nor substantiated for that purpose.

Mr. Sherwood: I think, your Honor, they have been substantiated in this respect. We have a question here of lost or missing records. The bank statements were in existence when Mr. Perenti made his examination. Mr. Murton died and they were lost except for 1950, and as to 1950, we have made a very complete presentation, with a complete breakdown, but the bank statements aren't here, yet Mr. Evje testified that they were the basis of Mr. Murton's running monthly reports which were summarized in the end of the year, and which were the reports which were given to Mr. Calegari for the purpose of filing the tax returns. That is what we have.

There is no use in our trying to say that we are going to produce something else because we haven't got it. Mr. Murton is dead. The bank records followed him, for all practical—disappeared with him for all practical purposes. We have made diligent effort, the evidence shows, to find them and we can't find them. They were in existence, and these reports were made from the bank reports at the time, and Mr. Evje told how it was done. That is secondary evidence but it is the best evidence we have. It is admissible because the primary evidence is not available.

Mr. Nyquist: Is Mr. Sherwood seriously con-

(Testimony of Adolph Calegari.)

tending [144] this is the amount of the cash bets in that year?

Mr. Sherwood: Cash bets?

Mr. Nyquist: Yes; is that your contention?

Mr. Sherwood: I am not making any contention about cash bets at all. I am contending that the reports that Mr. Murton made were adequate in so far as they purported to go. In other words, they were based on the bank account, and they also had the expenses which apparently aren't in controversy, but he didn't take into account the cash revolving fund or any other cash. Witnesses have so testified. I can't produce what I do not have, but I do think that we have, by laying a foundation that there were certain records, and those records were in the possession of Mr. Murton, and he died and the records disappeared.

The government's Revenue Agent, Mr. Perrenti, had a chance to look at those records when he made his audit prior to the last audit, and I can't see why the Court would keep out such evidence as the Petitioner has, even though it is secondary evidence, when the primary evidence has proved not to be available.

Mr. Nyquist: Mr. Sherwood says they can't produce evidence which they don't have, which of course is true. The reason he didn't have it—he tries to make it appear—is because they were lost, whereas, the testimony plainly shows that the taxpayer either failed to keep the records, or is un-

(Testimony of Adolph Calegari.)

willing to [145] produce records of the business that were had and the cash received.

The Court: It has been made rather plain that he didn't keep adequate records with respect to the betting commissioner activities as distinct from the card club. However, we don't seem to get anywhere attempting to refine this issue.

You go ahead, Mr. Sherwood, with your witness. We have ruled on everything now except Schedule C-1, and I think that you agree that there are some open spots in that connection.

Mr. Sherwood: I am going to ask Mr. Cohen about the bets-identified, but I think this witness could tell us where he got this figure of $42,058.75, which is stated to be bets-unidentified.

The Witness: I testified earlier that I didn't have the bank statement nor the cancelled checks for the month of January, 1950. However, I did get from the bank a copy of the bank statement. The bets-unidentified are the round figures in large amounts that appear on the January, 1950 bank statement for which we have no cancelled checks, and I have assumed that they were bets that couldn't be identified.

Q. (By Mr. Sherwood): Do you have that bank statement for January? As I understand your testimony, you didn't have the checks that would normally go with the bank statement for January. Your [146] testimony is that for large amounts which were withdrawn, you have assumed that those were issued in the payment of bets?

(Testimony of Adolph Calegari.)

A. That is right; if I may add something, that seems to follow the pattern for the remaining 11 months of that year.

Q. For the 11 months where you do have the checks, the larger checks are all in payments of bets? A. That is right.

Q. According to the information that you received? A. That is right.

The Court: As I understand it, you got that information from sources that are not in the record yet?

Mr. Sherwood: That is right.

The Court: Before I lose myself too much on these figures, when you are talking about bets now, are you talking about the total amount of bets or are you talking about commissions or what?

A. My understanding of that is that these checks were issued——

Mr. Nyquist: Objection, your Honor. I think that this witness was not there. I would think that he doesn't know what these bets were.

The Court: Counsel ought to be able to agree with me as to what the word "bets" means here.

Mr. Nyquist: I thought your question related to whether these were payments of individual bets or settlements [147] of accounts.

The Court: No; I am trying to keep this record as clear as I can. For instance, we start out with receipts-bets. We don't say there is anything to distinguish that from commissions earned from bets. I

(Testimony of Adolph Calegari.)

want to get the record clear by the statement of counsel.

Mr. Sherwood: The testimony of Mr. Cohen will show that the disbursements here by check were in payment of obligations which he had incurred by reason of accepting these wagers. It doesn't mean that he lost the money but it means he got the money from somebody else. He was primarily liable on all these things.

The Court: He places a beat for A, and balances it with B. B wins, and A pays up. That is a receipt.

Mr. Sherwood: Mr. Cohen would then pay B, but my point is if A didn't pay——

The Court: That is a disbursement.

Mr. Sherwood: But if A didn't pay for any reason at all Mr. Cohen still paid.

The Court: I don't want to get into argument, but the receipts-bets are what the losers pay, and disbursements of bets are what Mr. Cohen pays to the winner. I am leaving out the calculation of the commission.

Mr. Sherwood: That is correct, your Honor.

I would like to offer into evidence, and counsel has [148] no objection, the bank statement for the month of January, 1950.

The Court: Be received.

The Clerk: Exhibit 11.

(The document referred to was marked Petitioner's Exhibit 11 and received in evidence.)

(Testimony of Adolph Calegari.)

Mr. Sherwood: I think that covers everything we can get from Mr. Calegari.

The Court: You can withdraw him and put Mr. Cohen on. Do you want to cross-examine?

Mr. Nyquist: I would like to ask a couple questions.

Cross-Examination

By Mr. Nyquist:

Q. Mr. Calegari, did you ever see any record showing the amount of bets placed in any of these months? A. No, sir.

Q. Do you know whether there were any such records? A. I do not.

Q. And your figure that you have there is not based upon records of bets placed but is a calculated figure based upon other information?

A. Based on the amounts that were deposited in that account during the year.

Q. When you say "based upon that" and upon other information, is that right?

A. That is right. [149]

Q. It is a calculated figure that in substance is the figure which you know the bets must have been in order to produce a net income of the figure shown? A. That is right.

Q. One other question. Have you met Revenue Agent Glenn Adrian in this room?

A. Yes; I know Mr. Adrian.

Q. Prior to the issuance of the statutory notice, did you have a conversation with Mr. Adrian? To

(Testimony of Adolph Calegari.)

be more specific, did Mr. Adrian ask you for books and records of Les Cohen? A. No, sir.

Q. Did he ask you where the books and records of Les Cohen were? A. I don't believe so.

Q. Did you refer Mr. Adrian to Mr. John Lewis?

A. I believe that was a telephone conversation.

Q. Did you have a telephone conversation with Mr. Adrian about whereabouts of the records of Mr. Les Cohen?

A. Yes, I believe so. I think it was a telephone conversation and I told him that all of the records that I had were in Mr. Lewis' possession.

Q. This was prior to the issuance of the statutory notice?

A. I don't remember when the statutory notice was issued.

Q. The statutory notice was issued in November of 1952? [150]

A. I think it was subsequent to that. I am not sure. I haven't any record of the date of that telephone conversation but it seems to me it was after that time because this report is dated in 1954.

Q. But prior to your preparation of this report did you have a conversation with Mr. Adrian?

A. Yes; I believe it was prior to July 2, 1954, but I haven't the remotest recollection of when that was.

Mr. Nyquist: No further questions.

The Court: That is all.

(Witness excused.)

(Testimony of Adolph Calegari.)

Mr. Sherwood: Your Honor, during the recess we followed the Court's suggestion and counsel and the revenue agents discussed the Petitioner's Exhibit 8 in relation to the identification letter "B" in red which appears on this. That is Mr. Calegari's analysis of the bank account for the year 1950, and we have here all of the checks which were issued on that account in payment of obligations where a customer or another broker was entitled to collect from Mr. Cohen, and counsel had Mr. Adrian check these hurriedly, a spotcheck, and is willing, rather than identify each specific check, to ask Mr. Cohen the general questions as to what this symbol means on the sheet.

The Court: All right.

Mr. Sherwood: Mr. Cohen, will you resume the stand? [151]

Whereupon,

LESLY COHEN

the Petitioner herein, having previously been duly sworn, resumed the stand and testified further as follows:

Direct Examination
(Continued)

By Mr. Sherwood:

Q. I will ask you, Mr. Cohen, did you go over the checks for 1950 with Mr. Calegari?

A. At what time?

Q. Just recently? A. Yes, today.

Q. And did you, at the time you prepared these

(Testimony of Lesly Cohen.)

worksheets, tell him which ones of the checks he had on the sheets represented payment of bets?

A. That is right.

Q. You were in court while Mr. Evje described the way the accounts were kept at the Kingston Club, kept by Mr. Murton? A. Yes.

Q. Can you tell us why no more detailed records of cash were maintained during the period we have in question here?

A. On the commission account of the Kingston Club?

Q. Yes.

A. Well, I felt it was safer, and precautionary to keep as little memoranda in my possession in connection with that operation as possible, being that it was illegal and I was [152] always subject to being visited by law enforcement officers.

Q. In your opinion, did the amount which Mr. Murton employed actually reflect your income for those years? A. Yes, I believe so.

Q. And have you examined Schedule C of Exhibit 7, which I will now show you?

A. Yes.

Q. And in your opinion, does that correctly reflect your income from the Kingston Club in the three years in question here?

A. That is right.

Q. You stated, I believe, that the first part of your testimony, that you lived in a house with your brothers and sisters? A. That is right.

Q. During these three years? A. Yes.

(Testimony of Lesly Cohen.)

Q. And what were your expenses for living in that manner in those three years?

A. Are you speaking of household expenses?

Q. Yes, sir.

A. I would say approximately $100 a month.

Q. From what source did you defray those expenses?

A. That was usually paid by my brother Melvin out of my stock dividends. [153]

Q. Will you amplify that a little bit?

A. That $100 monthly?

Q. Tell us how your brother got the money and what he did with it?

A. Well, checks for the stock dividends usually were addressed to my home, 471-12th Avenue, and they were turned over to him and banked by him, and he would draw checks against the account to meet any household expenses charged against me.

Q. Did the other members of your family also contribute to the expenses of maintaining the home?

A. That is right.

Q. How many of you lived there?

A. In those years, a total of five.

Q. And who owned the house during those years?

A. That would be after my mother's death; my brother Herbert and I owned it.

Q. When did your mother die?

A. Approximately '47; '46 or '47.

Q. From what source were any other of your personal expenses paid?

(Testimony of Lesly Cohen.)

A. Usually from my checking account, personal checking account.

Q. For instance, if you bought clothes, how did you pay for them? [154]

A. As a rule, by check.

Q. And can you recall any large or unusual expenses that you had during these years?

A. I never had any personal expenses.

Q. Are all of the withdrawals that you made for your personal use or for any investment reflected in this statement which I exhibit to you, Petitioner's Exhibit No. 7?

A. My personal withdrawals are against my personal account.

Q. Are all the withdrawals that you made from the Kingston Club set forth in the schedules on the Kingston Club? A. That is right.

Q. In other words, the summary sheets which you received from Mr. Murton, in your opinion, correctly reflect your withdrawals?

A. That is right.

Q. And how often did you get reports from Mr. Murton? A. Once a month.

Q. Did you check them at the time?

A. Yes; I checked them.

Q. And those are summarized for you at the end of each year? A. That is right.

Mr. Sherwood: You may cross-examine.

The Court: Mr. Nyquist? [155]

(Testimony of Lesly Cohen.)

Cross-Examination

By Mr. Nyquist:

Q. Have you met Revenue Agent Glenn Adrian, who is at the end of the table here?

A. Yes, sir.

Q. Prior to the issuance of the notice of deficiency to you, did you have a conversation with Mr. Glenn Adrian about the whereabouts of your books and records? A. Yes, sir.

Q. And what information did you give Mr. Adrian at that time?

A. I referred him to Mr. Lewis.

Q. You told him Mr. Lewis had all the books and records? A. I referred him to Mr. Lewis.

Q. Didn't you tell him Mr. Lewis had your books and records?

A. No; I referred him to Mr. Lewis.

Q. Are you also sure about that?

A. I am positive.

Q. Where were your books and records at that time? A. I don't recall.

Q. Did you keep any sort of records on the monies received in your betting business?

A. In my bank business?

Q. Betting business. [156]

A. My betting business?

Q. Yes.

A. Not for any length of time, no, sir.

Q. Will you amplify that? You mean you kept a temporary record of bets placed but once they were

(Testimony of Lesly Cohen.)

paid off and the record was clear you did not maintain the records?

A. I destroyed them; that is right.

Q. Did you ever turn any records of your cash received over to Mr. Murton?

A. Any cash received?

Q. Yes? A. No, sir.

Q. Did you receive checks that didn't go into your bank account? A. Yes; on occasion.

Q. Did you receive cash that didn't go into your bank account?

A. Only to meet my revolving fund.

Q. Your answer is yes, you received cash that didn't go into the bank account? A. Yes.

Q. Did you ever tell Mr. Murton the amount of such cash?

A. No; when it got large enough I put it in the bank.

Q. Did you make large bank desposits of cash?

A. Not particularly. [157]

Q. Who kept your bank statement and your checks?

A. What do you mean by that question?

Q. Well, Mr. Murton apparently made certain calculations from them. What happened to them after that?

A. He had them, to my knowledge.

Q. Do you know when he destroyed them?

A. I have no idea.

Q. Or when they were lost? A. No.

(Testimony of Lesly Cohen.)

Q. Did you do any personal betting for pleasure outside of your regular business activities?

A. You mean now?

Q. Did you in these years? A. No.

Q. Did you have any safety deposit boxes during these years? A. Yes.

Q. Where was that?

A. Bank of America, Day and Night Branch.

Q. Have you read the stipulation of facts that was agreed to between your counsel and us in this proceeding in which a great many checks were itemized and detailed?

A. Checks that you have?

Q. Yes; checks of which we have photostats?

A. I understand you have a lot of checks but I haven't [158] read the stipulation.

Q. And you don't know what checks are covered in the stipulation? A. Definitely not.

Q. You don't know whether the stipulation reflects all the checks that you received in these years? A. I didn't read the stipulation.

Mr. Nyquist: May I have the Court's file?

Q. (By Mr. Nyquist): I show you the petition and the court legal file in this case and ask you if that is your signature on that?

A. That is right.

Q. You swore to the statements contained therein? A. That is right.

Q. You swore that you are familiar with the facts in this statement and that they are true,

(Testimony of Lesly Cohen.)

except as to those stated upon information or belief, and those you believe to be true?

A. That is right.

Q. I call your attention to a statement in paragraph II of the stipulation, or of the petition, rather, the second sentence:

"Petitioner caused true and complete books of account to be maintained in respect of all the transactions of the said Kingston Club, which books were kept by a reputable [159] duly licensed public accountant with offices in San Francisco, California."

Is that statement correct?

A. That was for the Kingston Club?

Q. Yes.

A. Kingston Club proper?

Q. Kingston Club proper. By that you mean you are qualifying that you do not mean it was for the betting activities which are sometimes listed as Kingston Club activities? A. That is right.

Q. You mean this statement doesn't relate to your betting activities?

A. That is right. My commission activities, not my betting activities.

Q. When you use the term "Kingston Club" in your testimony, you are talking about Kingston Club income, and in talking about these schedules, are you talking about income from your betting activities?

A. My commission activities.

Q. Yes.

(Testimony of Lesly Cohen.)

A. The Kingston Club and the commission activities were two separate activities.

Q. And wherever the term "Kingston Club activities" is listed in these, in Mr. Calegari's report with respect to what you testified, you were not referring to your commission [160] activities; is that right? A. That would be correct.

Q. Your commission activities were something over and above and different from the Kingston Club? A. That is right.

Mr. Nyquist: Your Honor, I wish at this time, to be sure we have the record preserved, wish to offer in evidence the Petition, the Answer and the Reply as the next exhibit in order.

The Court: You are offering the petition for what purpose?

Mr. Nyquist: I understood from a remark your Honor made earlier that to protect the record I ought to offer it.

The Court: I didn't say that.

Mr. Nyquist: I gathered from a remark made earlier that you had.

The Court: The rule says that whatever is alleged in the pleading and not denied is admitted. The question of how you prove it is up to you. It seems rather better to me to introduce those items of the pleadings that were applicable into the record. I can't imagine you wanting to offer the Petition wholesale, or the Answer. Of course, the Answer is your own, or the Reply wholesale.

(Testimony of Lesly Cohen.)

Mr. Nyquist: I think it would keep the record down if I limited my offer. [161]

The Court: I think you want to offer what you intend to prove and for whatever purpose; if you want to offer the correctness of Mr. Cohen's petition, it is all right with me.

Mr. Nyquist: I am offering the Petition only to show that Mr. Cohen swore to certain statements. I am certainly not admitting the correctness of any statements therein.

The Court: Take your time and analyze it, if you want. I didn't think you meant it, but that is what you were apparently saying.

Mr. Nyquist: Let us take these items one at a time.

The Court: The witness has testified that he swore to the Petition. What is it about the Petition that you want to bring out that you haven't already brought out?

Mr. Nyquist: I think so far as the Petition is concerned I have brought it out. I will offer in evidence Paragraph 7-A of the Respondent's Answer, and will ask that it be stipulated that in the reply to the Respondent's Answer there is reply to all of Paragraph 7 except 7-A. There is no reply to 7-A.

Will you stipulate to that?

Mr. Sherwood: The record speaks for itself; whatever that says.

The Court: Let me see that.

(Testimony of Lesly Cohen.)

To shorten it up, you are offering Paragraph 7-A of [162] your Answer, which reads:

"Petitioner during the years 1948 to 1950, inclusive, and prior thereto, was engaged in various business activities, i.e., as a bookmaker and betting commissioner in the City of San Francisco, California, and elsewhere."

And you are directing the Court's attention, as I understand it, that no reply was made to subparagraph (a) of Paragraph 7 which I have just read into the record; is that right?

Mr. Nyquist: That is right.

Mr. Sherwood: We have not agreed to any admission of their own self-serving answer in evidence, if that is what you mean.

The Court: You are not agreeing to the correctness of subparagraph (a) except in so far as you didn't deny it in your reply.

Mr. Sherwood: But we are taking no position on it at all. I don't think the answer is any evidence or proof of anything.

The Court: Well, it is offered solely for the purpose of showing an allegation of fact which wasn't denied.

Mr. Sherwood: That is right. It could be brought up in argument at any time, I take it.

The Court: Mr. Nyquist, I think partly because of my remark, you have offered the actual pleading in evidence, and the fact that it was not replied to. I just want to make sure counsel understands that. [163]

(Testimony of Lesly Cohen.)

Mr. Sherwood: I understand what he has done. I don't see the materiality of it. I think the answer speaks for itself.

The Court: I am not deciding anything, but what he is going to claim is that this petitioner was a bookmaker, among other things, and betting commissioner because he alleged it and you didn't deny it. It is up to counsel to look after themselves in their own way on it, and I am merely pointing it out.

So proceed, gentlemen.

Q. (By Mr. Nyquist): Do you have before you a copy of Exhibit 7? I call your attention to Exhibit a in Exhibit 7. There is an item in there, "Personal expenses to balance, year 1948, $10,578."

Can you tell us what that item consists of?

A. Mr. Calegari probably can help me on it.

Q. I am asking you, if you know the answer?

A. No, I can't say that I know the answer.

Q. Did you give that figure to Mr. Calegari?

A. No.

Q. And is the same true of the other, similarly the two items for the two succeeding years on that same page?

The Court: What page is that?

The Witness: Exhibit A.

Mr. Nyquist: Exhibit A of Exhibit 7. [164]

The Court: You mean Schedule A?

Mr. Nyquist: It is called Exhibit A.

The Court: Yes, I see.

The Witness: No, I did not give it.

(Testimony of Lesly Cohen.)

Q. (By Mr. Nyquist): The figures to Mr. Calegari? A. No.

Q. What sort of things did your personal expenses consist of? Did you travel?

A. I never made a trip in approximately fourteen years.

Q. Did you go to Reno? A. Never.

Q. Give us a rough estimate of how much of your business was local and how much was out of town business?

A. I couldn't estimate that very well.

Q. Was your local business largely a cash business? A. I would say so.

Q. That is to say, people would come in, pay cash and you would pay out cash?

A. That is right.

Q. Whereas your out of town business was largely by check? A. Correct.

Q. Your out of town bettors, when they had a payment to make to you they would make it by check and you would remit by [165] check?

A. Correct.

Q. Whereas locally you would pay by cash or they would pay you by cash?

A. On the other hand, the local people on occasions where they paid cash I had to pay by check.

Q. But in general it was cash locally?

A. Correct.

Q. Check out of town? A. Correct.

The Court: I think if you will take your eyeglasses away from your mouth you will talk clearer.

(Testimony of Lesly Cohen.)

The Witness: Yes, your Honor.

Q. (By Mr. Nyquist): Did you ever tell Mr. Murton that all of your receipts didn't go into the bank account?

A. I never told him anything.

Q. Did you ever tell Revenue Agent Perenti that all your receipts didn't go into the bank account?

A. I don't believe I had conversation with Mr. Perenti.

Q. Did you ever tell Adrian that all your receipts didn't go into the bank account?

A. I never discussed it with Mr. Adrian.

Q. Did Mr. Adrian ever make a demand upon you for your books and records? [166]

A. A demand or a request?

Q. Let's say a request for your books and records? A. Yes; he asked for them.

Q. And he handed you a letter from the Commissioner of Internal Revenue?

A. I don't recall the letter.

Q. Did you allow Mr. Adrian to examine any of your records?

A. I referred him to Mr. Lewis.

Q. I notice among your 1950 checks which you have identified as being in payment of amounts you owed on some of the wagering transactions, checks payable to a Myron Beck. Did you receive checks also from Myron Beck? A. Myron Beck?

Q. Yes.

A. I knew a Mr. Beck. I can't recall the name Myron.

(Testimony of Lesly Cohen.)

Q. You can't recall the name Myron Beck?

A. I know Beck, yes. I don't recall the name Myron.

Q. You have identified a check payable to Myron Beck as being a payout of a bet?

A. That is right.

Q. That must be the man you are speaking about? A. Could be.

Q. Did you receive checks from him also during these years? A. I believe so. [167]

Q. And did these checks go into your bank account?

A. I don't recall what disposition was made of them.

Q. And as to—did you in the course of your business activity place bets with Harold's Club in Reno? A. That is Mr. Beck.

Q. That is also Mr. Beck?

A. That is Mr. Beck.

Q. Harold's Club is Mr. Beck?

A. What is Mr. Beck?

Q. Mr. Beck was what, an owner at Harold's Club?

A. He might have had an interest, but I think he operated the horserace business in the club.

Q. Then if you made a check payable to Harold's Club in the amount of $608 on September 18, what would be the nature of that payment?

A. Horserace transaction.

Q. And would you also during the course of the year probably have received checks from Harold's Club or Mr. Beck? A. I would say so.

(Testimony of Lesly Cohen.)

Q. Do you know what disposition you had made of those checks?

A. Offhand I wouldn't know.

Q. You wouldn't know whether they go into your bank account or would not?

A. No. [168]

Q. I show you photostat copies of 11 money orders issued upon the Manufacturers Trust Company of New York, New York, in various sums, all papable to you and bearing your endorsement.

I have an understanding with counsel that the best evidence rule is waived here, that these photostat copies are accepted by him.

A. That is right.

Q. Are these checks, copies of checks received by you on or about the dates shown thereon?

A. I wouldn't know the dates but I recognize my signature. I can't deny that.

Q. And do you know whether or not these checks went into your bank account? A. No.

Q. At the Anglo-California?

A. I don't remember that.

The Court: Do you have many more questions from this witness?

Mr. Nyquist: I think I have five minutes more and should probably finish, your Honor.

The Court: I don't want to rush you. I just want to find out.

Q. (By Mr. Nyquist): I also show you two checks on the Hibernia Bank, [169] signed Joseph Bradway—correction. I show you photostatic copies

(Testimony of Lesly Cohen.)

of two signed checks payable to cash, bearing your endorsement.

Were these checks received by you?

A. My endorsement is on them. They must have.

Q. And finally I show you a check of the Horseshoe in the amount of $5,500, dated March 6, 1950; this is a photostatic copy. Is that also your endorsement on that? A. Yes, sir.

Mr. Nyquist: I offer in evidence as a single exhibit this group of checks.

The Court: Any objection?

Mr. Sherwood: No objection.

The Clerk: Exhibit F.

(The document referred to was marked and received in evidence as Respondent's Exhibit F.)

Q. (By Mr. Nyquist): Just to save time I will refer to this entire group of checks which you have identified as being payouts made by you during the year 1950? A. Payments?

Q. Payments made by you in the year 1950, and I will ask you whether the parties to whom you made those payments were also parties who would from time to time during that year be making payments to you? [170]

A. In most cases I would say yes. Some of the names I wouldn't know anything about.

Q. Would you know in any particular instances whether payments you received would be deposited

(Testimony of Lesly Cohen.)

in your account or whether the checks would be cashed or used in some other way?

A. I couldn't positvely say.

Q. Let us refer to these checks that you have received during these years in question, from various other men engaged in betting activities throughout the country. Would the individual checks which you received ordinarily be in payment of individual bets or would they ordinarily be settlements of account after a group of transactions which might go either way?

A. I would say settlements of accounts over a period of time.

Mr. Nyquist: I have no further questions of this witness.

The Court: I am going to recess for dinner in just a minute. Are you going to reoffer Schedule C-1? It seems to me that the only consistent thing I can do is to admit it subject to motion to strike and argument on the brief, so we will have all the schedules objected to open for argument and motion to strike on brief.

I have a note here that we will all be permitted to go out and come back again, except I am not going out at all. [171] I am notified that each person must sign in and the guard would like a list of the names of all persons who will return so will all of you who expect to come back give your name to Mr. Baird so he can give it to the guard.

How much time do you want for dinner, gentlemen? I don't know what facilities are here and it

(Testimony of Lesly Cohen.)

makes no difference to me because I am not going out.

Mr. Nyquist: Forty-five minutes.

The Court: Make it forty-five minutes. If you come in sooner you can let me know. I gather that is enough for both counsel. If you want longer, I will give you more time.

Mr. Nyquist: I wonder if we might have one witness out of order. I think we will dispose of him in five minutes?

The Court: You want to go ahead now?

Mr. Nyquist: If we could take five minutes.

The Court: I haven't any objection. Of course, Mr. Sherwood hasn't had his chance for redirect.

Mr. Sherwood: I have no objection, your Honor.

The Court: Are you going to have this witness back on redirect?

Mr. Sherwood: Yes; but if he wants to get rid of the witness I have no objection.

Mr. Nyquist: I would like to save this witness from having to stay away from his family for the evening.

The Court: All right. [172]

(Witness excused.)

Whereupon,

ROBERT K. LUND

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: Please state your name and address?

The Witness: Robert K. Lund, Assistant Chief Intelligence Division, Internal Revenue Service, San Francisco, California.

The Clerk: Will you state your address?

The Witness: 262 Lake Drive, Berkeley 8, California.

Direct Examination

By Mr. Nyquist:

Q. Mr. Lund, did you ever investigate the affairs of Mr. Cohen?

A. No; I did not, personally.

Q. Did you ever make an investigation in which the books and records of Mr. Cohen became material to your investigation, or an object of your search?

A. I made inquiries about Mr. Cohen's books, yes, sir.

Q. Will you tell us when and where you made those inquiries?

A. On April 17, 1952, I went to Mr. John V. Lewis' office to inquire as to the availability of Mr. Cohen's betting [173] records, and also as to whether or not he would be available to testify regarding transactions he had had with the taxpayer who was under investigation. I asked Mr. Lewis

(Testimony of Robert K. Lund.)

about this matter, the availability of both the books and Mr. Cohen, and he stated that "I have all of Mr. Cohen's books in my office and I will think about it and let you know later."

Q. Did you receive any further word?

A. I have no independent recollection of ever receiving an answer to it. I may have but I have no recollection of it now.

Mr. Nyquist: No further questions of this witness.

Cross-Examination

By Mr. Sherwood:

Q. This investigation which you were conducting was of a taxpayer not Mr. Cohen?

A. That is right.

Q. And that was in the year 1952?

A. Yes.

Q. And as I recall it, Mr. Lund, in 1952, there was great activity in San Francisco in connection with matters involving commissioners and other people engaged in wagering?

A. Well, it was nationwide.

Q. There was a nationwide upheaval?

A. Yes, sir.

Q. And the law enforcement agencies such as the police [174] department and county governments and state attorney generals' offices were watching these investigations and in many cases were collaborating with them?

A. Well, I wouldn't say that was quite true, Mr.

(Testimony of Robert K. Lund.)

Sherwood. The Internal Revenue Service had its own program.

Q. I understand that but the evidence that was uncovered at that time was also pertinent to inquiries made by the Attorney General of California, for example?

A. Well, it might have been, but I have no personal knowledge of any inquiries they may have made. We didn't collaborate with the Attorney General or local law enforcement people. We were making income tax investigations.

Q. I seem to recall a great many releases made by the Attorney General's Crime Commission.

The Court: Where are we going, Mr. Sherwood?

Mr. Sherwood: We will try to remove any question about the fact that the records were not made available. I think Mr. Cohen has given the fact, but of course, these records they wanted might have been very dangerous for Mr. Cohen to have parted with.

The Court: They might have been.

Mr. Sherwood: Entirely apart from tax matters.

The Court: If you want to press along those lines.

Mr. Sherwood: I think it is unnecessary to go any further. [175]

The Court: Any redirect?

Mr. Nyquist: No redirect.

(Witness excused.)

Mr. Nyquist: I have one other witness who will

testify to the same thing. Maybe counsel is willing to stipulate to the same thing.

The Court: I guess you better put him on.

Mr. Nyquist: Mr. Doherty.

Whereupon,

WILLIAM J. DOHERTY

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows :

The Clerk: Will you please state your name and address?

The Witness: William J. Doherty, 336 Bonacin Avenue.

Direct Examination

By Mr. Nyquist:

Q. Your occupation?

A. Special Agent with the Internal Revenue.

Q. Did you at any time have an occasion to make a search for the books and records of Lesly Cohen?

A. Yes; I was assigned to the case in early 1953 and my group supervisor knew they were having trouble getting the records. He encountered me one day and said—— [176]

Mr. Sherwood: Wait a minute. Is this a conversation between you and your group supervisor?

The Court: Mr. Doherty, you know perfectly well you are not supposed to testify to a conversation along those lines. Strike that answer. You can

(Testimony of William J. Doherty.)

start fresh with him, and you will answer such questions as are asked, and only what is asked. If counsel wants to ask you anything further, he will do so.

Go ahead.

Q. (By Mr. Nyquist): When were you assigned to this case? A. In early 1953.

Q. And what did you do with respect to the books of Lesly Cohen?

A. On October 7, 1953, I called Mr. Lewis, and I said to him that "in connection with your offer to make the records of Mr. Cohen available to our office now, Mr. Wilks told me you had promised to give them to us." He replied that Wilks was crazy, that he had never promised that we could ever see the records and we weren't going to see the records then either.

Q. Did you ever see the records? A. No.

Mr. Nyquist: No further questions.

Mr. Sherwood: No questions. [177]

The Court: You are excused.

(Witness excused.)

The Court: Anything further at the moment? I gather you will return in forty-five minutes then, which will be seven o'clock.

(Whereupon, a recess was taken until 7:00 o'clock p.m., of the same day.) [178]

Evening Session

(Court met, pursuant to the taking of the recess, at 7:00 o'clock p.m.)

The Court: Proceed.

Mr. Sherwood: The last two witnesses were taken out of order. Our rebuttal will be presented after the conclusion of the respondent's case, and we will call Mr. Cohen back to the stand to finish our case in chief.

The Court: Mr. Cohen, resume the stand.

Whereupon,

LESLY COHEN

the Petitioner herein, having previously been duly sworn, resumed the stand and testified further as follows:

Redirect Examination

(Resumed)

By Mr. Sherwood:

Q. Mr. Cohen, in answer to a question on cross-examination concerning keeping track of the transactions which you had as a betting commissioner, you stated, did you not, something about having them on a sheet?

I wonder if you would elaborate a little bit on that and tell the Court what these sheets were.

A. Well, I used what is termed as a master sheet in recording the individual transactions so that I could keep track of what was going on during the course of the day.

(Testimony of Lesly Cohen.)

Q. On a busy day, would there be a large number of [179] transactions on that sheet?

A. Approximately 100.

Q. And as I understand it, you might have one in a certain amount and you should have to balance that off with others of varying amounts so as to strike a balance? A. That is right.

Q. What happened to those sheets?

A. Well, they were just kept for reference purposes, maybe for one day or two days and destroyed.

Q. You heard Mr. Evje testify that he picked up certain memorandums concerning cash expenditures for expenses, did you?

A. Those were daily expenditures picked up at the end of each month, or the first of each month.

Q. Who wrote those memos?

A. I usually compiled them.

Q. On direct examination this afternoon, I think you identified Exhibit 10, which comprise three sheets, being the annual statement for 1948, 1949 and 1950; do you recall that you looked at them this afternoon? A. Yes.

Q. And I believe you also testified at that time that the data set forth thereon was true to your best knowledge? A. That is right.

Q. Then on cross-examination you made some sort of a distinction between the Kingston Club and the card game, and I [180] am wondering if you would care to explain that a little further; in other words, do you now wish to correct anything that you said on your cross-examination?

(Testimony of Lesly Cohen.)

A. I probably was confused by the question.

Q. What do you mean?

A. Well, the entire Kingston Club net figure was based on the annual report as presented by Mr. Murton.

Q. And when you testified this afternoon that the schedules prepared for you by Mr. Calegari contained information which you believe to be true, it did include the transactions of the betting commissioner's business as well as the card room?

A. Yes.

Q. And where these sheets refer to horses, that embraces the entire betting commissioner's activities? A. That is right.

Q. I take it that term "horses" was put in there in Mr. Coplin's time when the business was confined to horses? A. That is right.

Q. But in your case it covers all sorts of athletic events? A. That is right.

Q. Going back to some questions that were asked of you, some of them by the Court and some of them by both counsel regarding the actual mechanism of making these bets, and in [181] which you gave an illustration of A making a bet on one side and B making a bet on the other, in those cases would A and B have any direct contact with each other?

A. Definitely not.

Q. And in the event that A won and B lost, who actually paid the money that he had won?

A. I did.

(Testimony of Lesly Cohen.)

Q. Were there ever instances where you were unable to collect from the losing party?

A. Oh, certainly.

Q. And in that event did you pay the winner just the same?

A. Absolutely; that was my obligation.

Q. So that you were responsible for all of the commitments which you made even though you would not yourself be reimbursed by the loser?

A. That is right.

Q. Did that happen with any frequency during the time you operated the commissioner business at the Kingston Club?

A. Well, no, I watched my credits pretty carefully.

Q. Did you have any particularly large losses in any one of these three years?

A. Yes; in 1950 I sustained a couple severe losses.

Q. What were they?

A. Well, in round figures, I would say about $25,000. [182]

Q. Spread over how many persons who owed you money? A. Two outstanding accounts.

Q. Could you tell us approximately what each one of those was in amount?

Mr. Nyquist: Objection, your Honor. This is inducing a new proceeding into issue; nothing in the pleading about bad debts. I think we are introducing a new type of deduction and new issue in here.

Mr. Sherwood: It is neither a new issue or a

(Testimony of Lesly Cohen.)

new deduction. It is simply an amplification of the accounting method used because, of course, the accounting method which Mr. Evje described would take this into account, so I am not claiming there is any new deduction, but I am trying to explain the evidence which is already introduced of the bank deposits and withdrawal, most of which has been introduced in the stipulation which was prepared by the Respondent. I think it is relevant.

The Court: I will overrule the objection.

The Witness: What was the question?

Q. (By Mr. Sherwood): I asked you to give the detail on those large bad accounts?

A. They were spread over the entire year, practically.

Q. What did each of them amount to in round figures? A. Separately? [183]

Q. Yes. A. I would say 14,000 and 10,000.

Q. And those sums represented amounts which you were, nevertheless, obliged to pay to the winner on various wagers? A. That is right.

Q. In regard to that petition which you signed, I call your attention to the statement in there which counsel read to you; where you said that you had maintained adequate books. At that time had anyone told you whether or not your books were adequate? A. No.

Q. Had Mr. Murton ever told you anything about them?

Mr. Nyquist: Objection, your Honor. These questions are based upon a mis-statement of the

(Testimony of Lesly Cohen.)

petition. He states that—he is talking about a petition that states he kept adequate books. That is not the way the statement in the petition was made.

Mr. Sherwood: I am referring to whatever statement you read to the witness, to save time. I didn't get the pleading.

The Court: The witness made it perfectly clear, I thought, that he claimed he kept adequate books as to the card room or card club and he didn't keep adequate records as to the betting commissioner's activities.

Mr. Sherwood: He stated that, but when he came back [184] after dinner, your Honor, he pointed out at that time that he was under a misapprehension in distinguishing the two activities because they were both embraced on those same exhibits, and he has reiterated his testimony that he believes the records in both cases are accurate.

The Court: I don't see any objection to him expressing a belief, whatever it may be worth.

Mr. Sherwood: I have forgotten the question. May I have it read?

(Question read.)

Q. (By Mr. Sherwood): On the basis of the conversation which you reported in your direct testimony that you had with Mr. Murton, did you believe that the records of the betting commissioner were adequate for tax purposes? A. I did.

Mr. Sherwood: That is all, your Honor.

(Testimony of Lesly Cohen.)

Recross-Examination

By Mr. Nyquist:

Q. Returning to this statement, in Paragraph II, of your petition, in which you say: "Petitioner caused true and complete books of account to be maintained in respect of all transactions of said Kingston Club, which books were kept by a reputable duly licensed public accountant with offices in San Francisco," did that statement, when you use the word [185] "Kingston Club" in that statement, did you have reference to your betting commissioner activities? A. At that time I believe so.

Q. You believe that you were referring to your betting commissioner activities, including them in the term "Kingston Club" when you state that you caused true and complete books of account to be maintained in respect of all transactions?

A. Right.

Q. And did you cause such true and complete books of account to be maintained with respect to all transactions?

A. What do you mean by the question, sir?

The Court: Mr. Cohen, you know perfectly well you didn't keep complete books on your betting commissioner work, don't you?

Mr. Cohen: I did not, your Honor, but I kept complete records as regarding the finances.

The Court: All right; go ahead. Counsel stated in the opening statement that because of the type

(Testimony of Lesly Cohen.)

of illegal business you were in, that you didn't keep a record of a great many things concerning it, and I don't know whether you testified to the same thing or not, but you didn't keep the names of the people that you dealt with, or the specific amounts with respect to any individual's longer than a day or so, did you?

The Witness: That is correct, your Honor. [186]

The Court: There wasn't any way anybody could look at your books and inquire whether a certain bet was made or wasn't made. You had no record of that kind?

The Witness: That is right.

Q. (By Mr. Nyquist): On this matter of daily cash expenditures, who made this expenditure of cash for operating the expenses of the Kingston Club? A. I did.

Q. What sort of memorandum would you prepare? A. Just a plain memorandum.

Q. To show money that you paid out in cash?

A. Correct.

Q. Where would you get this money?

A. Usually out of my funds.

Q. What funds? A. Revolving funds.

Q. And that revolving fund would later be built up from other cash receipts?

A. That is correct.

Q. So it would be maintained at its normal level?

A. Correct.

Q. Were any of these daily cash expenditures to members of the local police department?

(Testimony of Lesly Cohen.)

A. No, sir. [187]

Q. Were any expenditures to members of the local police department? A. No, sir.

Q. You talked about certain bets that you were unable to collect. Did you keep track of the amount of these? A. The total amount?

Q. Yes. A. Oh, yes.

Q. Did you show that in any figure that you turned over to Mr. Murton? A. No, sir.

Q. It wasn't shown on your income tax return?

A. No, sir.

Q. What did you say the total amount was?

A. Approximately $25,000.

Q. For what years?

A. I believe it was either for '50 and '51 or for '50.

Q. '50 or '51 or is that the total?

A. Either '50 or '51, or '50 and '51.

The Court: You don't know which?

The Witness: No, sir. No, your Honor.

Q. (By Mr. Nyquist): And you say there were two individual bettors? A. Correct.

Q. Who were these two individuals? [188]

A. Mr. Bobby Evans of Portland, Oregon, and Joe Gillio, who was representing, or at least he said he was representing Corbetts in San Francisco.

Q. You received a number of checks from Bobby Evans throughout the year? A. I did.

Q. But at the end you say he still owed you money? A. Correct, sir.

(Testimony of Lesly Cohen.)

Q. What efforts did you make to collect this money?

A. I have contacted Bobby Evans by phone many times during the intervening years. He just hasn't got it financially. If he had it I am sure he would have met the obligation. As for Gillio, I just feel that whether or not he has it, he won't meet it anyway.

Q. What did you do in 1950 about collecting these amounts?

A. I made every effort possible to collect them.

Q. What do you know about the financial condition of these individuals in 1950?

A. I felt they were solvent or I wouldn't have extended the credit to them.

Mr. Nyquist: No further questions, your Honor.

Mr. Sherwood: No further questions, your Honor.

The Court: All right; you are excused.

(Witness excused.) [189]

The Court: Is that your case?

Mr. Sherwood: Is this our case? Yes, your Honor.

The Court: Very well. Mr. Nyquist?

Mr. Nyquist: I call Internal Revenue Agent Glenn Adrian.

Whereupon,

GLENN H. ADRIAN

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: Please state your name and address.

The Witness: Glenn H. Adrian, 2341 Fifth Avenue, San Rafael.

Direct Examination

By Mr. Nyquist:

Q. What is your occupation?

A. Internal Revenue Agent.

Q. How long have you been a Revenue Agent?

A. Since 1941, with the exception of three and a half years spent in the Navy.

Q. And what is your educational background?

A. Graduate of Ben Franklin University in Washington, D. C.

Q. In what? A. Accounting. [190]

Q. Did you make an investigation of the income taxes of Lesly Cohen for the years 1948 through 1950? A. Yes, sir.

Q. Was the notice of deficiency on which the Petition was filed in this case based upon your examination? A. Yes.

Q. In making your investigation, did you examine the books and records of Lesly Cohen?

A. No, sir.

Q. Why not?

A. They weren't available to me.

(Testimony of Glenn H. Adrian.)

Q. What effort did you make to get them?

A. Well, I had the returns assigned to me for investigation and to the best of my memory I called Mr. Calegari whose name was on the returns. He wasn't in. I contacted Mr. Melvin Cohen, the brother of Lesly Cohen, and he advised me that he tried to get in touch with Lesly and that ended the conversation. To the best of my recollection I called Mr. Calegari about a week later and he advised me that Mr. John Lewis had all the books and records and that I was to deal with him in the future. This was in April of 1952. After several attempts I finally got hold of Mr. Lewis on the phone and advised him that I had the returns for 1948 and 1949 for pre-examination, and the 1945 for the original examination. He advised me that he understood that Mr. Cohen's books, or [191] returns had been audited for 1948 and 1949 and that he wouldn't show me any records in regard to them. I said, "Do you mean 1950 also?" He said, "Well, he would take a look at the records that he had and let you know." A week or so passed and after a few attempts I finally reached him on the phone again and he told me that he had looked at the records and he wouldn't show me anything.

Along some time in May, I, in conference with my group chief, caused a registered letter to be sent to Mr. Cohen asking that he appear in the office with his records.

Q. Did you obtain authorization from the Commissioner of Internal Revenue for re-examination

(Testimony of Glenn H. Adrian.)

of the years 1948 and 1949? A. Yes, sir.

Q. And did you advise Mr. Cohen that you had such authorization? A. Yes, sir.

Q. Did you furnish him with a copy of the Commissioner's letter of authorization?

A. Yes, sir.

Q. Did you request of Mr. Cohen his books and records for those years?

A. I caused to be sent to Mr. Cohen another letter in September of 1952 asking to explain why he hadn't appeared with his records from the prior registered letter sent to him. I received no answer. Mr. Lewis sometime after this, a week [192] or ten days in September, contacted my group chief and told him that at the termination of a case he presently had in court that he would contact me. I never heard from anyone after that and I subsequently submitted my report in October, 1952.

Q. How did you proceed with your examination in the absence of books and records?

A. Through the use of third party records.

Q. Where did you go and what did you do?

A. Well, I went to the Market-Ellis Branch of the Anglo-California National Bank, and there were schedules made of all the deposits that the taxpayer had made, and there were schedules drawn off as best as could be found in the bank's records of every deposit, deposit tag for 1948 and 1950.

Q. What records did you find at the bank?

A. The deposit tags, which showed the checks deposited and the identification of the issuing banks

(Testimony of Glenn H. Adrian.)

on there; there were no names, and the amount of the check, and the copies of the bank statements which were naturally sent by the bank to the taxpayer, and on which were shown the total deposits, and the checks written on the account. There were no names or identification at all.

Q. Is this Exhibit 5-E, which is part of the petition, the summary of the information obtained from the deposit tags at the bank?

A. Yes, sir. [193]

Q. What other information did you have in addition to the bank records?

A. Well, I received a lot of information from other Internal Revenue Agents offices throughout the United States which constituted photostats of checks which were paid or endorsed by Mr. Cohen.

Q. Are these some of the photostats of which you speak? A. Yes, sir.

Q. Have you read the stipulation of facts in this proceeding? A. Yes, sir.

Q. Is most of the material that you found covered by that stipulation of facts? A. Yes, sir.

Q. What did you do with this information once you obtained it?

A. As I mentioned a moment ago, there was a complete analysis made of the deposit tags by which the items making up the deposits were identified, and with these checks that I had I would check them against this schedule and determine whether the check had been deposited or undeposited, and I separated them into the different schedules, one

(Testimony of Glenn H. Adrian.)

showing the total deposited and the other showing which had been cashed by Mr. Cohen, but not deposited.

Q. And is that information reflected in the stipulation [194] of fact? A. Yes, sir.

Q. I show you a group of checks which are marked Exhibit F, and I ask whether you have, at my request, checked to determine whether any of those were deposited in Lesly Cohen's bank account?

A. I have checked and they are not deposited.

Q. That is, they were cashed but not put in the commercial account at the Anglo-California National Bank; is that right?

A. Well, they show that they are cashed and they show that they are not deposited.

Q. Were you able to locate all of the checks which were deposited in Lesly Cohen's commercial account during the years 1948 through 1950?

A. No, sir.

Q. Can you tell us approximately what percentage of the checks you were able to locate for the year 1948?

A. Of the checks which I had, which I received, which were deposited, I imagine I had one-fifth; from the records which could be checked by the facts stipulated to, approximately one-fifth.

Q. You found approximately one-fifth of the deposited checks? A. Yes, sir. [195]

Q. And for the year 1949, about what fraction?

A. Approximately 50%.

Q. Half of the deposited checks you located?

(Testimony of Glenn H. Adrian.)

A. Yes.

Q. My question was '49; and for the year 1950, approximately what percentage?

A. Approximately 50%.

Q. After you made this breakdown between the deposited and undeposited checks, what did you do with the figures?

A. I took the total deposits of that schedule which has been stipulated to and took the total and to that I added the undeposited checks.

Q. One moment; you say the total deposits which had been stipulated to. Let me ask you, did you have all of the checks that are in the stipulation at the time you made your report?

A. No, sir; some of those checks, quite a few, in fact, have been received by our office after my case was submitted in October, 1952. Some of those names were new to me. I never heard of them before.

Mr. Sherwood: I am not objecting, but to clarify my point, as I understand it, the first thing he said was he took the bank deposits; that is far as he got. He was going to say something more but you interrupted him, but all the bank deposits, I would assume, included checks, no matter where [196] he got them; is that right?

The Witness: Yes, sir; that is right.

Mr. Sherwood: Do you see my point? It didn't make any difference whether he had the checks before or after; he had all the bank accounts. Now

(Testimony of Glenn H. Adrian.)

he is going to add something, but we haven't got that far.

The Court: What you said is correct as to those that were deposited. Go ahead.

Q. (By Mr. Nyquist): What did you do with the information you then had as to deposited and undeposited checks?

A. Well, I took the deposited checks, as combined in that schedule which has been stipulated to, and to that I added the undeposited checks which I had verified against that schedule and found not to have been considered before, and then also I added to that the wins from the Film Row Club and totalled that up as to me known income, and that was the figure which was used in the computation of the tax in each of the years considered.

Mr. Sherwood: May I ask one question? When he says "deposited" does he mean all the deposits, including cash? He said checks.

Q. (By Mr. Nyquist): You mean all the deposits?

A. The deposits stipulated to, sir, which—in those [197] deposits in that schedule there are checks and cash and the schedule will show what it is.

Mr. Sherwood: You confined your statement to checks. It was the total deposit, checks and cash?

The Witness: Yes, sir.

Q. (By Mr. Nyquist): You mentioned the Film Row Club. Will you tell us what information you had about the Film Row Club?

(Testimony of Glenn H. Adrian.)

A. There was an examination made by our office of the Film Row Club, and during the examination there was given to the agent the records, and in the records were bets with Mr. Lesly Cohen, and the agent gave to me a transcript of the wins and losses, and I used that transcript, as I say. I took the wins and put them in my schedule as gross income or as income.

Q. And did you allow any of the losses as deductions? A. No, sir.

Q. Why was that?

A. Well, the taxpayer was on a cash basis, and he should substaniate his losses or payouts and there was no substantiation given me. I was refused the records, and I would gladly have considered them, but I had nothing to substantiate or allow losses on.

Q. Did you make a computation of Lesly Cohen's income for these years by the net worth method?

A. I considered it. [198]

Q. Did you do it? A. No, sir.

Q. Why?

Mr. Sherwood: I don't think that is revelant, why. The fact is he didn't do it. I object to it on that ground, your Honor.

Mr. Nyquist: The petition alleges that the Commissioner was completely arbitrary in his method of going at these things here, and I am trying to show why the Commissioner's representative did not use one method which Petitioner's counsel now urges or is trying to introduce evidence on.

(Testimony of Glenn H. Adrian.)

The Court: I will overrule the objection.

Q. (By Mr. Nyquist): Why did you not use the net worth method?

A. Well, taxpayer dealt in large sums of cash and I didn't feel that I could accurately determine a net worth with that in mind, and I had been refused the records and I would not know what was in the taxpayer's books or how he made his investments, and I didn't think I could accurately determine it.

Mr. Nyquist: No further questions.

Cross-Examination

By Mr. Sherwood:

Q. Do you have with you this schedule that you said was given to you by the investigating agent in the Film Row Club? [199]

A. I don't have it but it is a part of the file.

Q. From your file could you give us the figures, substantially?

A. In 1948 the wins were about $62,000.

Q. Just a moment; what were the losses in that year? A. I don't recall, sir.

Q. Do you have information from which you could give us that? A. Yes, sir.

Q. Would you mind stepping down and getting it. A. Yes, sir.

(Witness leaves stand.)

Q. Can you state now by refreshing your memory with the memorandum you have before you,

(Testimony of Glenn H. Adrian.)

what the schedules showed as to losses to the Film Row Club in 1948? A. $79,075.

Q. And can you give——

A. For the accuracy of it, my information from this same schedule, I would like to give you the correct win figure, $61,965.

Q. And can you give us corresponding figures for the year 1949?

A. The wins, $63,500; the losses, $65,912.50.

Q. Would you give us the figures for 1950?

A. That taxpayer refused to give his records to our [200] office and I don't have any figures on 1950.

Q. Then may I assume that you didn't add anything to the bank deposits and undeposited checks in 1950? A. Yes, sir.

Q. That was a very awkward question I asked. The fact is you did not add anything to the undeposited or the deposited amounts in the bank on the undeposited checks for 1950?

A. No, sir; I took no action at all on his activity with the Film Row Club in 1950.

Q. You stated, I believe, that you prepared the deficiency notice, the 90-day letter?

A. I submitted a report. I presume those figures were from my report.

Q. And wasn't there also a jeopardy assessment levied prior to that time?

A. I believe that it was practically at the same time; I don't know. That is another department.

Q. To clear up that matter that you were talking about concerning checks which cropped up after

(Testimony of Glenn H. Adrian.)

the deficiency notice was issued, in so far as those checks were included in the bank deposit, you had already taken them into account? A. Yes, sir.

Q. And were there any substantial number of checks that cropped up which were cashed instead of deposited subsequent to the issuance of the deficiency notice? [201]

A. Yes, sir; there were quite a few. I don't have the figures at my fingertips. I don't think I can tell you. They are in some of the schedules I think the attorney has.

Q. In any event, they are all included in the stipulation? A. Yes, sir.

Mr. Nyquist: In the stipulation or in the checks that are entered as an exhibit?

Mr. Sherwood: Yes; I will amend it to include the checks that counsel just put in evidence.

Q. (By Mr. Sherwood): When you submitted your report in 1952, was it—— A. Yes.

Q. ——you knew that the records of the Film Row Club showed that Mr. Cohen had sustained a net loss in that operation?

A. Taking these figures, if every bet was carried to a conclusion, yes, sir.

Q. And you had just as much reason to give good faith, believe the figures as to the losses as you did to the wins, did you not?

A. Sir, may I answer that in this way?

Q. Just answer it yes or no; then you may explain it.

(Testimony of Glenn H. Adrian.)

A. Would you repeat the question?

Q. You had just as much reason to think that the Film [202] Row Club records were accurate as to wins as they were to losses and vice versa?

A. Yes, sir.

Q. Going back to your conversation with Mr. Lewis concerning the records, which I think you have placed in April of 1952, isn't it a fact that at that time Mr. Lewis told you that he hadn't had an opportunity to study the records, was not familiar with the contents and would not give any client's records to the Revenue Service until he had first studied the records to ascertain what they contained?

A. No, sir; I stated exactly a moment ago——

Q. Isn't that the substance of the conversation?

A. No, sir; I would only answer it in the way I answered it before.

Q. Did he at any subsequent conversation with you tell you that he had given all of the records that he had to Mr. Calegari, that when Mr. Calegari had finished an analysis of them he would then let you know about it and submit to you the statement which Mr. Calegari was going to prepare?

A. The first time I met Mr. Lewis personally I was—that was in 1954.

Q. Was Mr. Calegari present at that time?

A. I don't know, sir, whether the first time I met Mr. Lewis was in the appellate office or in his own office. If it were in his own office Mr. Calegari was not there at that [203] time.

(Testimony of Glenn H. Adrian.)

Q. And if it was the other office?

A. He wasn't there that time either. There was a time I met Mr. Lewis with Mr. Calegari in Mr. Lewis' office. It seems to me it was subsequent to the first time that I met him personally.

Q. On one occasion you did meet Mr. Calegari in Mr. Lewis' office? A. Yes, sir.

Q. And at that time were you told that Mr. Calegari either had made or was going to make a complete study and analysis of the available records? A. Yes, sir.

Q. And at that time or subsequently was the report given to you, two copies, in fact?

A. Yes, sir.

Q. And were you also told that you were welcome to use any of the material that Mr. Calegari had which he had used in the compilation of this report? A. In 1954, yes.

Q. In the course of making this investigation, were you aware of the fact that Mr. Cohen was a betting commissioner? A. Yes, sir.

Q. And did you make any allowance in making your report for any sums which he might have had to pay out from the bank [204] deposits or the checks which were cashed without being deposited?

A. As such I made no adjustment.

The Court: What do you mean "as such"?

The Witness: Because, your Honor——

The Court: Did you make any adjustment in any way?

The Witness: He asked me if I made any allow-

(Testimony of Glenn H. Adrian.)

ance, and I say as such I did not, but I may have made an allowance in this manner. The amounts received indicated many times pennies running into 25, 50 or 75, and that indicated to me that it must have been a settlement of something, and maybe the payoff had been allowed on the amount I included on income.

Q. (By Mr. Sherwood): That was your conjecture? A. Yes, sir.

The Court: Broadly speaking you didn't allow any payout?

The Witness: No, sir. I would have been glad to if I could have had some substantiation. There was no substantiation and I didn't.

Q. (By Mr. Sherwood): You have today in Court examined the checks which are on the table in front of you there? A. Yes, sir.

Q. Which embraces payouts from the bank account for the [205] year 1950, commencing about February 1st? A. Yes, sir.

Q. Is there anything that you have uncovered in your investigation that would lead you to believe that the same pattern would not develop if we had the bank records for 1948, and 1949?

Mr. Nyquist: Objected to as calling for a conclusion of this witness. He didn't have these checks before him at the time he made his examination. His examination was not based on these checks and therefore this type of conclusion is a conclusion that might be proper for the Court to draw, but not necessarily in conclusion for this witness.

(Testimony of Glenn H. Adrian.)

The Court: I will have to hear the last two questions and answers prior to the objection.

(Questions and answers read.)

Mr. Nyquist: I call the Court's attention to the fact that these checks and records, and so forth, of which he speaks are not material, that were submitted to Mr. Adrian at the time Mr. Adrian made the determination on which the 90-day letter is based.

The Court: He asked him whether the pattern is the same. He asked him whether there was anything to indicate that it would not be the same.

Mr. Nyquist: Asking him for an opinion.

The Court: He is asking whether this witness has [206] found anything. I would like the question to be rephrased, Mr. Sherwood, if you would be willing to do it. I am not quite sure that it is clear in my own mind what you are asking for. First of all, the pattern as to what?

Mr. Sherwood: The withdrawal of funds from the bank account.

Q. (By Mr. Sherwood): Perhaps I can get at it this way: You did, I believe, testify that you had received from the bank all of the bank statements for the entire three years in question?

A. Yes, sir; I examined them on their premises. I didn't have them in my possession.

Q. You didn't photostat them?

A. No, sir.

Q. And to refresh your memory, I will show you bank statements for one month, which is evidence as

(Testimony of Glenn H. Adrian.)

Exhibit 11. You will recall that is for the month preceding the checks about which we have just been discussing? A. Yes, sir.

Q. When you examined the bank statements at the bank, isn't it true that the same type of withdrawal, same general pattern appeared on all of the statements, for all three years?

A. I suppose it did. There is no name here, no identification; there is nothing to lend any credence as to what they are for or that they are productions. I imagine that the [207] statements have lots of figures like this on them.

Q. And from your general investigation you are aware of the fact that a betting commissioner necessarily has to pay out money?

A. A betting commissioner, yes, sir.

Mr. Sherwood: That is all.

Redirect Examination

Q. (By Mr. Nyquist): Mr. Adrian, on cross-examination the subject was brought up of a meeting with Mr. Lewis on Mr. Calegari in which you were given a copy of a report of Mr. Calegari and were told that you could have access to certain records? A. Yes, sir.

Q. Did this meeting take place in the course of your investigation of this case? A. No, sir.

Q. Did it take place subsequent to the issuance of the 90-day letter? A. Yes, sir.

Q. Was that at the time the case was before the appellate staff? A. Yes, sir.

Q. And you were called upon by the appellate

(Testimony of Glenn H. Adrian.)

staff to obtain additional factual information at that time? A. Yes, sir. [208]

Q. There has been some discussion of the checks which are not in evidence but are on the table there, checks for the year 1950, which the witness testified represented payments. Did you have access to those checks at the time you made your examination? A. No, sir.

Q. Did you have access to any of the taxpayer's records? A. No, sir.

Q. The point has been brought up that you include the receipts from the Film Row Club, rather, you included the wins from the Film Row Club in your receipts as you determined them, but you did not allow deductions for losses at the Film Row Club.

Have you any basis for making a distinction between the two types of transactions?

A. Well, the wins would presumably have been included and the cash payments which would have been made on those which were local bettors, as far as I could determine, were not a part of my records. I had no way to substantiate them, and it is not the policy to allow a deduction or a payment until it can be substantiated or determined to be legal and legitimate expense.

Q. Did you have any reason to believe that Mr. Cohen would be able to substantiate that production if it were properly allowable when the time came? [209]

A. I was told he had complete records and they

were in the hands of his attorney and I imagined that would come about in due course.

Mr. Nyquist: That is all.

Mr. Sherwood: No further questions.

The Court: The witness is excused.

(Witness excused.)

Mr. Nyquist: Respondent rests, your Honor.

Mr. Sherwood: That concludes the Petitioner's case, your Honor.

The Court: How much time do you want for briefs? Incidentally, I don't know whether it would save time or not, but sometimes it does in a complicated case. Are counsel satisfied to have seriatim briefs or do you want simultaneous briefs?

Mr. Sherwood: I should think seriatim would possibly be better in this case.

The Court: Do you have any objection?

Mr. Nyquist: I have no objection to seriatim briefs.

The Court: How much time do you want for your opening brief?

Mr. Sherwood: Sixty days, your Honor.

Mr. Nyquist: I would like sixty days, your Honor.

The Court: How much do you want for reply?

Mr. Sherwood: Thirty. [210]

The Court: Very well. Is there anything further, gentlemen?

Mr. Sherwood: Nothing further.

Mr. Nyquist: Nothing further.

The Clerk: Those dates are Petitioner's briefs on or before May 28; Respondent's answering brief

on or before May 28—on or before July 27, and Petitioner's reply on or before August 27, 1956.

The Court: That is all, then.

(Whereupon, at 8:30 o'clock p.m., the hearing was concluded.)

Filed April 5, 1956. [211]

[Title of Tax Court and Cause.]

FINDINGS OF FACT AND OPINION

Held:

1. That, where petitioner received almost all of his income from the illegal operation of a "betting commissioner" enterprise, and kept no permanent records of his transactions in that capacity, respondent's use of the bank deposit method in determining petitioner's income was not arbitrary or invalid.

2. That certain losses from gambling are to be allowed to the extent of gambling gains.

3. That petitioner understated taxable income on his returns for each of the years 1948, 1949 and 1950. Amounts of understatements determined.

4. That a part of the deficiency in each of the years 1948 through 1950, inclusive, was due to fraud with intent to exade taxes.

JOHN V. LEWIS, ESQ., and
CLYDE C. SHERWOOD, ESQ.,
For the Petitioner.

CHARLES W. NYQUIST, ESQ.,
For the Respondent.

[Seal]

Fisher, Judge: This proceeding involves deficiencies in income tax and additions to tax determined against petitioner as follows:

Year	Deficiency	Sec. 293(b) Addition to Tax
1948	$ 538,911.40	$269,455.70
1949	426,038.44	213,019.22
1950	228,561.34	114,280.67
Total	$1,193,511.18	$596,755.59

The issues presented for our consideration are: (a) whether respondent's use of the bank deposit method was justified; (b) whether certain losses from gambling are to allowed to the extent of gambling gains, (c) whether, and to what extent, petitioner omitted taxable income from his return for each of the years 1948, 1949 and 1950; and (d) whether any part of the deficiency for each of the years in question is due to fraud with intent to evade tax.

Findings of Fact

Some of the facts are stipulated and to the extent so stipulated are incorporated herein by reference.

Petitioner, Lesly Cohen, during the taxable years in controversy herein, resided in San Francisco, California, and was unmarried. Petitioner filed his individual tax returns for the calendar years 1948

through 1950, inclusive, on a cash basis with the then collector of internal revenue for the first district of San Francisco, California.

Lesly was born and educated in San Francisco. He worked on a local newspaper, the San Francisco Bulletin, as a copy boy, and eventually became a sports writer and member of the sports staff. About 1934, when the Bulletin was sold to another publisher, petitioner became a free-lance writer on sports subjects, editing boxing magazines and doing publicity work for various athletic events.

During the taxable years in question, petitioner lived modestly in his mother's home with two brothers and two sisters.

During World War II, Lesly was inducted into the United States Army. Upon his discharge, he returned to California and soon thereafter became acquainted with Coplin who owned and operated the Kingston Club (111 Ellis Street), in San Francisco. A "card room" was maintained as part of the club's operations. The same premises were used by Coplin for his "betting commissioner" business, which consisted largely of placing bets on horse races on a commissioner basis. The latter venture was in violation of both State and local law. Coplin, desirous of expending his gambling activities to embrace other athletic events, invited petitioner to join his betting commissioner enterprise as a limited partner.

In the latter part of 1947, Coplin died, and about January, 1948, Lesly took over the operation of the

Kingston Club. Thereafter, until the latter part of 1951, when the Federal Gambling Stamp Tax law was put into effect, Lesly operated the club's card room and betting commissioner activities as sole proprietor. During the years 1948, 1949 and 1950, Lesly's activities as betting commissioner included not only horse racing, but other sports events. He was unable to estimate what proportion of the bets handled by him grew out of horse racing and what out of other sports events. Petitioner's activities as betting commissioner, and his operation of the card room were his only income-producing activities during the years in question, other than a small amount of income derived from investments in securities with his brother Herbert. In his personal gambling activity at the Film Row Club, his losses exceeded his gains. The gains and losses from his limited activities as bookmaker about balanced each other.

Petitioner's primary function as betting commissioner was to obtain opposite parties to a wager, receiving for his services a "commission" or fixed percentage of the amount involved in the wager. Ordinarily, Lesly would quote prevailing odds on horse races and other athletic events and if a customer wished to make a wager, petitioner would attempt to locate others to accept or "cover the bet" in the same amount. Normally, petitioner did not accept a wager as "placed" until he had found some other individual to "lay off" the other side of the same event. When petitioner was able to "lay off" the entire amount of the bet, petitioner's profit

or loss would not depend upon the outcome of the event, but would be a fixed percentage or "commission" of the total wager, which petitioner retained on each bet. When able to do so, petitioner would lay off the bet with one or more of his own local customers. When this could not be accomplished, he would lay off or cover the bet with other betting commissioners in the San Francisco Bay area and in other cities. He would not bring the customers betting on opposite sides of the same transaction into personal contact so that they could bet with each other. When Lesly located a client willing to accept the other side of a bet, he would confirm acceptance of the wager by telephone. Lesly was personally responsible for the collection of all betting commitments which he made, and had to pay the winner even if he was unable to collect from the loser. Petitioner watched his credits closely.

The commission to petitioner on bets handled for his own customers was 5 per cent on each bet handled by him, except that on horse racing bets only the loser paid a commission. These commissions were not split. On bets laid off with other betting commissioners, the commission was usually split, half going to petitioner. At times, he found it necessary to waive his entire commission in order to get the bet laid off with another betting commissioner.

Occasionally, through miscalculations, on petitioner's part, or other unforeseen circumstances, he accepted a bet and could not arrange to lay if off. He then found it necessary to carry the other part

of the bet. On these occasions, he acted as bookmaker to the extent that he himself carried the bet. Except for such occasional instances, he did not carry any part of the bet himself.

Petitioner's betting commissioner enterprise was operated almost entirely on a credit basis. Comparatively insubstantial amounts of money were actually posted with petitioner prior to the happening of the event which determined the wager. Normally petitioner collected cash from local bettors and paid local winners in cash. Cash settlements were made with local customers following the happening of the sporting event. Settlements with other commissioners in the San Francisco area were likewise mainly in cash. Transactions with out-of-town betting commissioners were generally settled at periodic intervals by check. The periods varied, and included settlements on a daily, weekly or monthly basis, or when the account reached a certain fixed sum in favor of petitioner or the out-of-town broker. Such settlements were in effect the balancing of accounts between petitioner and out-of-town betting commissioners. They usually represented the net amount due from a number of bets rather than a single bet. When it was necessary for petitioner to remit to an out-of-town broker to settle an account, petitioner usually sent his own personal check. Occasionally he was required to send cashier's checks. Petitioner was unable to estimate what proportion of his betting commissioner transactions were with out-of-town brokers. The handling of bets of local

customers as betting commissioner on a commission basis was a substantial part of petitioner's business.

Petitioner maintained a "revolving fund" of about $3,000 in cash, which he used in making pay outs to local winners. Checks, most of which were received from out-of-town brokers, were either deposited in petitioner's commercial bank account or were endorsed and transferred, or cashed by petitioner. The only cash deposits in petitioner's commercial bank account during the years in question were, in the aggregate, as follows: 1948-$430; 1949-$8,470; 1950-$13,955. Petitioner received cash from local bettors far in excess of the foregoing amounts in each of said respective years. His records of cash transactions as betting commissioner were kept only a few days until settlement was made. He never furnished to his accountant any records of his cash transactions or cash commissions received as betting commissioner. In preparing data for petitioner's income tax returns for the years in question, neither the accountant who assembled the data nor the accountant who prepared the returns from said data took into consideration any undeposited cash.

Throughout the years 1948, 1949 and 1950, petitioner maintained a commercial bank account in the name of "Les Cohen" at the Market-Ellis Branch of the Anglo-California National Bank, San Francisco, California, where he deposited funds relating primarily to his activities as betting commissioner. The total deposits to petitioner's commercial ac-

count in said bank for each of the years involved herein were in the following amounts:

Year	Amounts
1948	$508,384.23
1949	404,118.69
1950	283,129.80

Said deposits largely represented receipts from other betting commissioners in settlement of accounts.

The foregoing deposits consisted almost entirely of checks. During the entire three-year period in question the total amount of cash included in said deposits (detailed supra by years) was less than $25,000. Deposits totaling $2,905 were made to said account on January 3, 1951.

During each of the years in controversy, petitioner received a large number of checks payable to "Les Cohen" which were endorsed by him but not deposited. The total amounts thereof and the respective years in which received were as follows: 1948-$120,974.75; 1949-$107,712; 1950-$22,613.75. These undeposited checks likewise largely represented settlement of accounts.

Petitioner made payments by check in the settlement of accounts with out-of-town bettors totaling $292,283.46 in the year 1950.[1]

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[1]Petitioner, in his proposed Finding No. 50, and respondent, in his proposed Finding No. 83, take the position in effect that payments in unspecified amounts were made under similar circumstances in 1948 and 1949.

During the taxable years in question, petitioner did not maintain any permanent or detailed records or formal books reflecting gross commissions or gross receipts and disbursements from his betting commissioner activities. Petitioner was apprehensive that the possession of such records would be both incriminating to him and embarrassing to his customers if they fell into the hands of the law enforcement officers. For his own reference purposes, however, he kept a daily "master sheet" at the Kingston Club setting forth the transactions which he handled as betting commissioner. On a busy day, approximately 100 wagers were recorded thereon. After a day or two, when the master sheets had served their immediate purpose, they were destroyed to avoid possible seizure and use as evidence by police authorities. The effect of such destruction was likewise to render it impossible to make an accurate determination of the amount of his commissions received as betting commissioner. No record of such commissions was maintained by petitioner.

Petitioner retained George T. Murton (formely the accountant for the Kingston Club during the years Coplin operated the club) to maintain its records, and Murton, or Evje, an accountant in Murton's firm, performed such service for petitioner during the years in question.

Murton's procedure was to go to the Kingston Club at least once a month and take off the record of income and disbursements from the card room. He also collected memorandum sheets upon which

the petitioner had noted daily cash expenditures. Receipts or paid bills were usually attached.

Murton took the bank statements and canceled checks and reconciled the bank statements with the check book stubs.

The books of account of the card room were either used at the card room by Murton or taken to his office and returned to the card room where they were kept.

The bank statements, canceled checks, and memoranda of cash expenditures were kept by Murton either at his home or in his office.

Murton compiled the results of his accounting work in a so-called ledger which was actually a compilation on columnar work sheets.

Murton's method of arriving at petitioner's gross income at the end of each year was as follows: He subtracted the amount in the bank at the beginning of the year from the amount in the bank at the end of the year. He then added to the net increase or decrease in the bank balance all of the expenses of the business and all of the withdrawals made by or for the petitioner. The result was considered petitioner's gross income from the Kingston Club.

The accountants disregarded cash receipts (other than those deposited and reflected in the bank balance) and also disregarded cash payouts except those payouts substantiated by a memorandum from petitioner. This was done on the theory that the $3,000

revolving fund remained approximately the same throughout the period.

From the gross income thus arrived at Murton would deduct the petitioner's deductible expenses.

Petitioner did not inform Murton that he received a substantial amount of checks in each of the years in question in connection with his business as betting commissioner which he endorsed but did not deposit.

For about five months in 1950, while Murton was ill, Evje acted in his place and followed the same methods. Evje never saw any books recording cash receipts or betting records relating to petitioner's activities as betting commissioner. Murton died some time in 1951.

All business expenses listed on Murton's summaries and claimed as deductions on petitioner's returns were allowed by respondent.

Annual summary sheets were prepared by Murton and furnished to petitioner and mailed to Calegari, a certified public accountant who prepared petitioner's income tax returns. The summary sheets for the three years here involved were furnished by Murton to Calegari and were used by the latter in the preparation of said income tax returns. Calegari did not keep any books or records for the Kingston Club operations or for any of petitioner's betting commissioner activities. The only records maintained by Calegari relating to petitioner's financial affairs was a set of books for Lesly's in-

vestment in various stocks and bonds, which he held as a joint venturer or partner with his brother Herbert.

In the preparation of petitioner's income tax returns for the years in question, Calegari was not given access to any books or records that may have been maintained with respect to the Kingston Club or for any of petitioner's betting activities. In preparing petitioner's income tax returns, Calegari relied on the annual summary sheets and profit and loss statements of the Kingston Club operations, which were sent to him by Murton.

About the end of 1950, petitioner's Federal income tax returns for the years 1948 and 1949 were audited by Internal Revenue Agent Parenti. The bank statements, cancelled checks and memoranda of cash expenditures referred to above, used in the preparation of the summary sheets for 1948 and 1949 by Murton, had been kept by the latter either at his home or in his office, and were made available to Parenti.

Parenti based his examination of petitioner's returns for 1948 and 1949 entirely on information and data furnished by Evje of Murton's office. After Parenti audited petitioner's returns for the years 1948 and 1949, he prepared and filed a report indicating deficiencies as follows: 1948-$5,505.67; 1949-$4,689.23.

At the time of the trial in the instant case, the bank statements and cancelled checks for the years

1948 and 1949 could not be found. Petitioner was able to produce only his cancelled checks for the last 11 months of 1950 and bank statements for the year 1950.

In 1952, Internal Revenue Agent Glenn Adrian conducted an original examination of petitioner's return for 1950 and a re-examination of his 1948 and 1949 returns. At this time there was a nation-wide investigation of betting commissioners and others engaged in gambling activities. As a result of this drive, Adrian had acquired, at the time of his investigation, photostats of checks paid to or endorsed by "Les Cohen," which had been received from other revenue agents' offices throughout the United States. Many of said checks had been endorsed and cashed by petitioner and had not been deposited in his commercial bank account. This information had not been available at the time of Parenti's examination.

Adrain obtained authorization from the Commissioner of Internal Revenue for a re-examination of petitioner's returns for 1948 and 1949, and a copy of said letter was furnished to petitioner. At the beginning of his examination, Adrian contacted Caligari and was advised by him that petitioner's attorney had all of petitioner's existing books and records. Later, an agent of the Intelligence Division of the Internal Revenue Service communicated with petitioner's attorney and was informed that the attorney had all of Cohen's books in his office. In May, 1952, Adrian caused a registered letter to be sent to peti-

tioner requesting that he produce his records, and a follow-up letter was sent to petitioner in September of 1952. Petitioner neither answered the letters nor produced his books and records. Thereafter, Adrian contacted petitioner's attorney who informed the agent that he would look at the records in his possession and would let Adrian know whether he could see them. Later the attorney informed Adrian that he had looked at the records and that he would not show Adrian anything.

Adrian proceeded to make his audit on the basis of third-party records to the extent that they were available. The available records were (1) bank deposit tags which showed dates and amounts of deposits and a number identifying the banks on which the deposited checks were drawn, but no names identifying the makers of the checks; (2) copies of bank statements of petitioner's accounts showing total deposits, and amounts and dates of payment of checks drawn on the account, but without names or other identification of payees; (3) photostatic copies of checks payable to Les Cohen obtained from other internal revenue agents' offices, and (4) a transcript of an account on the books of the Film Row Club showing petitioner's wins and losses from personal bets at that club.

Petitioner's wins and losses from gambling at the Film Row Club were as follows:

Year	Amount Won	Amount Lost
1948	$61,695.00	$79,075.00
1949	63,500.00	69,912.50

Respondent computed petitioner's taxable income for the years in question by the so-called bank deposit method. He determined that all monies deposited in the commercial bank and all checks received and endorsed but not so deposited (to the extent he had knowledge of them at the time the statutory notice was mailed) and all wins from the Film Row Club constituted income. Because of lack of substantiation, no deductions were allowed for pay outs or losses. None of the deductions claimed on petitioner's returns were disallowed.

Revenue Agent Adrian did not attempt to compute petitioner's net income by the so-called net worth method because petitioner dealt in large sums of cash and the agent did not feel that he could accurately determine net worth for that reason and also because, having been refused petitioner's books, he would not know how petitioner made his investments.

In petitioner's tax returns for 1948 through 1950, inclusive, on Schedule C, page 2 (profit or loss from business), the nature of the business was stated to be "brokerage."

Gross profits (listed as total receipts) from the Kingston Club operations are reported on petitioner's tax returns for the years 1948 and 1949 in the amounts of $56,795.13 and $66,274.91, respectively. On petitioner's original income tax return for the year 1950, he reported gross profit (listed as total receipts) from Kingston Club in the amount of $1,836.28, and a net loss of $26,687.91. On July

28, 1954, petitioner filed an amended return for the the year 1950 on which he reported gross income (listed as total receipts) from Kingston Club of $8, 207.71 and a net loss of $15,125.75.

During the years involved herein, Lesly had a safe deposit box at the Bank of America, Day and Night Branch.

During each of the taxable years in question, petitioner received substantial commissions in cash from local customers. His settlements with local betting commissioners were almost entirely in cash, and reflected his share of commissions.

Petitioner's gross income from his activities as betting commissioner and the operation of the Kingston Club card room for the respective years in question did not exceed the following: 1948-$167,000; 1949-$145,000; 1950-$108,000.

Petitioner, in his income tax returns for each of the years in question, substantially understated income from his activities as betting commissioner and the operation of the Kingston Club card room.

A part of the deficiency for each of the years involved was due to fraud on the part of petitioner with intent to evade taxes within the meaning of section 293(b).

Opinion

Respondent's Determination Not Arbitrary

Respondent determined deficiencies herein by treating as income for each of the years 1948

through 1950, inclusive, the full amounts of bank deposits made by petitioner to his checking account, certain undeposited checks received by him in each of said years which were cashed or endorsed and transferred by him to others, plus winnings (without allowing losses) by petitioner from gambling at the Film Row Club in the years 1948 and 1949. Part of the deficiency for the year 1948 represents interest in the amount of $159.12, which petitioner received in connection with a refund of Federal income tax, and which was not included in his reported income for that year. This item is not in dispute.

It is conceded that petitioner carried on an extensive business during the years in question as a betting commissioner, much of which was handled by cash transactions. It is also conceded that he maintained no records of commissions earned, bets placed, receipts (including cash) or pay outs (also including cash). Under the circumstances, we have no doubt that respondent was justified in making his determinations on the basis of the bank deposit method.

In Doll v. Glenn, 231 F. 2d 186 (C.A. 6, 1956), the Court said, in part (p. 188):

> In the absence of the books and records of the Doll Lumber Company, the Commissioner was justified in treating the deposits in the bank account of H. A. Doll as gross income with the burden resting upon the taxpayer to

> show what amounts, if any, were nontaxable income, and what deductions, if any, should be properly credited against it. Hoefle v. Commissioner, 6 Cir., 114 F. 2d 713; Hague Estate v. Commissioner, 2 Cir., 132 F. 2d 775, 777-778, certiorari denied 318 U.S. 787, 63 S. Ct. 983, 87 L.Ed. 1154; Goe v. Commissioner, 3 Cir., 198 F. 2d 851, certiorari denied 344 U.S. 897, 73 S. Ct. 277, 97 L.Ed. 693; Leonard B. Willits, 36 B.T.A. 294, 297; * * *

See also Fada Gobins, 18 T.C. 1159, 1168 (1952), affd. per curiam 217 F. 2d 952 (C.A. 9, 1954); Sterns v. Commissioner, 235 F. 2d 584 (C.A. 9, 1956), affirming a Tax Court Memorandum Opinion.

Petitioner complains that neither he nor his counsel ever knew what information was the basis of respondent's determination until almost the close of the trial. If petitioner or his counsel deemed such knowledge significant to the preparation of the case, a motion should have been filed to require respondent to "file a further and better statement of the nature of his claim" under the provisions of Rule 17(c)(1) of this Court. Petitioner's brief argues that he was unaware, until the agent testified, that respondent had added to income the wins at Film Row Club, but had made no allowance for losses. (See discussion, infra.) The agent testified as to the amount of the losses, as well as the gains, however, and we have allowed the losses to the extent of the

gains (see infra). We may add that petitioner made no motion to hold the record open for the production of additional evidence on this issue on the ground of surprise. We are unaware of any prejudice to petitioner arising out of the circumstances alluded to in this paragraph. In any event, no steps have been taken by petitioner to remedy such prejudice if, by any chance, it existed.

Petitioner's fundamental objection, however, is to the effect that respondent's determination was arbitrary and without rational foundation. Petitioner urges this view in two respects. The first is that respondent's determination was arbitrary because he included all gains from gambling at the Film Row Club as income and allowed no losses as balancing deductions. While, as will appear infra, we hold that Film Row Club losses are to be allowed to the extent of Film Row Club gains, it does not follow that respondent was arbitrary in refusing to do likewise. The agent's testimony explaining the basis for the statutory notice (which is the only evidence in the record in relation thereto) is to the effect that losses were disallowed because they were unsubstantiated, and also because taxpayer was on the cash basis and, assuming the losses were paid, the year or years of payment had not been shown. We think both views are tenable. It is clear that respondent, in the exercise of his judgment in making his statutory determination, may properly place the burden on the taxpayer of establishing all of the elements

upon which the right to deductions is based. See Helvering v. Taylor, 293 U.S. 507 (1935); Burnet v. Houston, 283 U.S. 223 (1931); Doll v. Glenn, supra. A holding by this Court, on the record before us, disagreeing with some part of respondent's determination is not of itself equivalent to a finding that the determination was arbitrary. See Bodoglau v. Commissioner, 230 F. 2d 336 (C.A. 7, 1957), affirming 22 T.C. 912. If the rule were otherwise, we would find it necessary to invalidate, in toto, every determination with which we did not wholly agree. Such a view would emasculate the well established rules relating to the burden of proof and seriously undermine the effect of the statutory notice upon which the principle of the burden of proof is founded in the usual situation.

Although we hold, infra, that respondent erred in failing to allow gambling losses to the extent of gambling gains, petitioner has not been prejudiced thereby because we have made such allowance (see discussion, infra). On the other hand, however, as will also appear infra, we think respondent was clearly right in disallowing the excess of gambling losses over gambling gains.

Petitioner next urges that respondent was arbitrary in treating deposits as gross income, but failing to allow any deductions or eliminations for "pay outs." Petitioner argues that respondent must have known that the very nature of petitioner's business was such that pay outs were necessary. As will appear infra, we have ma-

terially reduced respondent's determination. Again, however, this is not tantamount to a holding that the determination was arbitrary or invalid in whole or in part. Petitioner did not offer any substantiation of pay outs. He did not maintain any records from which pay outs could be calculated. The fact that his failure to do so was because of fear that they might be found by police authorities, and used in the prosecution of petitioner, and others operating illegal enterprises is hardly binding upon (or in any sense appealing to) respondent or to us. Inability to meet the burden of proof on the part of the petitioner does not shift the burden to respondent. It merely leaves petitioner with an unenforceable claim (Burnet v. Houston, supra, p. 1930) due, in this instance at least, to his own culpable failure to keep records.

With respect to respondent's failure to reduce deposits (treated as gross income) by any unsubstantiated amounts of pay outs, we need not repeat our reference to the authorities referred to supra dealing with the burden of proof except to recall that in Doll v. Glenn, supra, the Court referred to the fact that in the absence of books and records, the Commissioner was justified in treating the bank deposits as gross income "with the burden resting upon the taxpayer to show what amounts, if any, were nontaxable income, * * *." [Emphasis supplied.]

It should be noted, also, that respondent based his determination of increases in business income

solely on deposits and undeposited checks endorsed by petitioner (plus Film Row Club gains without offsetting losses). It is clear from the record, however, that petitioner received very substantial amounts in cash which he did not deposit. Respondent, however, did not include any of such cash in determining unreported business income.

Petitioner refers to the fact that respondent's determination was based in material respects upon third party records. This, of course, was necessary in part because petitioner, in his business of betting commissioner, maintained no records of commissions earned, bets placed, gross receipts or pay outs, and, in part, because petitioner's counsel refused to turn over to the investigating agent those records which were available. (We are not questioning the reason, wisdom or justification for this refusal. We consider only the fact that the records were not turned over.) The respondent, however, is not required to make his determination on the basis of evidence legally admissible in a formal proceeding in court. Moreover, and particularly where the taxpayer fails to keep proper records available for audit, respondent must be given latitude (short, of course, of arbitrary action on his part) in the use of such investigative techniques as the circumstances afford.

It is clear that where petitioner asserts the invalidity of a determination, the burden is on him to establish such invalidity. In this connection, in Greenwood v. Commissioner, 134 F. 2d 915 (C.A.

9, 1943), affirming this Court's decision in 46 B.T.A. 832, the Court of Appeals said (p. 919):

> "Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid." (Helvering v. Taylor, 1935, 293 U.S. 507, 515 * * *), which burden is sustained by a clear showing that the determination was arbitrary or erroneous. * * *

Later (p. 922) the Court said:

> Petitioner has failed to overcome the presumption of validity attaching to the determination of the Commissioner, * * *

On the basis of the foregoing discussion, we hold that respondent's determination was not arbitrary or invalid.

Understatements

It is well settled that the burden of proof rests with petitioner to establish error in respondent's determination of a deficiency. In American Pipe and Steel Corporation v. Commissioner, 243 F. 2d 125 (C.A. 9, 1957), affirming 25 T.C. 351, the Court of Appeals said:

> Petitioner, having invoked the jurisdiction of the Tax Court, entered the hearing burdened with the duty of establishing by at least a preponderance of the evidence that the determination made by the Commissioner was erroneous. * * *

See also Greenwood v. Commissioner, supra.

We turn first to gains and losses from gambling at the Film Row Club. The amounts won and lost in 1948 and 1949 are set forth in our Findings. In each of the two years, the losses exceeded the gains. Respondent included the gains in gross income, but allowed no loss deductions. The information as to both gains and losses was furnished the investigating agent from records of the club and was received in evidence without objection. The agent frankly admitted that there was just as much reason to accept the record of losses as the record of gains. He appeared to have no doubt that both were correct, and made no suggestion that petitioner was in any way connected with, or had any interest in the club. The agent's real reason for disallowance of losses was that petitioner was on a cash basis, and the agent did not have information as to the year in which the losses were paid. We think, however, that we are justified in inferring that, to the extent the losses equalled the gains, the one was offset against the other and that separate payment of the losses was to that extent unnecessary. Accordingly, we allow the losses to the extent of the gains in 1948 and 1949. (The issue does not arise with respect to 1950.) We agree with respondent, however, in his refusal to allow any deduction for the excess of losses over gains. Here there is neither evidence of payment nor the year of payment. We hold, therefore, that deduction of the excess of losses over gains is not allowable.

On the question of petitioner's understatements of income as betting commissioner, we face a diffi-

cult task. We have no doubt from the record that the understatements for each year involved are quite substantial. It is, of course, impossible to determine such understatements with anything like accuracy or precision from this record. While the burden of proof is on petitioner, and the impossibility of accurate determination is engendered by petitioner's failure to maintain essential records for this phase of his business, we must deal with him as fairly as the circumstances which he has created will permit, and in spite of the fact that the fault is his. We recognize that, as betting commissioner, petitioner must have had substantial pay outs, but again we have no basis for calculating the amount thereof. At the same time, if we were merely to sustain respondent's determination, we think the result would obviously be harsh and unrealistic. We think our only proper course is to approach the problem indirectly by analysis of the record in the light of the principles established in Cohan v. Commissioner, 39 F. 2d 540 (C.A. 2, 1930). Our objective will be, after resolving any reasonable doubts against petitioner, to reconstruct his gross income as betting commissioner at a figure which in our judgment it would be unlikely to exceed in fact. (Petitioner, it is clear, has failed to establish a lesser amount.)

In Roberts v. Commissioner, 176 F. 2d 221 (C.A. 9, 1949), affirming 10 T.C. 581 (1948), the Court of Appeals said (p. 226):

The petitioner had kept no books. So the Tax Court had to determine the amount from such evidence as was presented to them. If the result is an approximation, the lack of exactitude is traceable to the petitioner's own failure to keep accurate account. As said by the Court of Appeals for the Second Circuit:

"Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making." Cohan v. Commissioner, 1930, 39 F. 2d 540, 543, 544. * * * [Emphasis supplied.]

In the instant case, we make no pretense at precision. We merely do our best to circumscribe the results within practical limits by the exercise of our judgment within the scope of the principles announced in Roberts, supra, and Cohan, supra.

The figures of gross income at which we arrive infra are substantially less than those determined by respondent. Respondent does not question petitioner's deductions.

In the year 1948, petitioner's deposits in his commercial account totalled over $500,000. Of this amount, the cash deposits were only a little over $400. It is clear that the remaining deposits largely represented remittances from out-of-town betting commissioners with whom petitioner "laid off" bets when he could not find local bettors to take the op-

posite side of bets which were offered to him. It must be remembered that petitioner rarely acted as bookmaker (and then only of necessity) so that when one of his customers desired to place a bet, it was necessary for him to procure a customer betting the other way, or lay off the bet with another betting commissioner. We must also remember that the bets placed locally (representing a substantial part of his business) were largely cash transactions, while the bets laid off with out-of-town betting commissioners were largely settled for by check or money order. Petitioner's deposits, therefore, were largely representative of the settlement of bets laid off with out-of-town commissioners, or the settlement of bets which they laid off with him. The credit balance could be in either direction, and took into consideration wins, losses, and commissions.

These deposits, however, obviously did not represent all of the bets laid off. They represented not the result of an individual bet, but a settlement of accounts which usually represented the net result from the placing of more than a single bet. Moreover, in 1948, petitioner received checks in excess of $120,000 which he either cashed or endorsed to others. These checks likewise represented net figures in the settlement of accounts involving a number of bets rather than a single bet.

In addition, petitioner issued substantial checks, largely to out-of-town betting commissioners, representing the settlement of accounts where the net

credits were in their favor. The amount of such checks for 1948 is not in the record, but the total of such checks in 1950 exceeded $290,000 and it appears from petitioner's proposed Finding No. 50 and respondent's proposed Finding No. 83 that both parties are satisfied that the same general pattern of payments by check existed in 1948 and 1949.

The total of checks deposited, checks cashed or endorsed, and checks issued represents a minimum of layoff bets, because, as already indicated, they represented settlement of accounts arising out of more than one bet. The total of layoff bets, therefore, must have materially exceeded such total.

Before turning to local bets, we note at this point that in laying off bets with other betting commissioners, petitioner normally received only one-half of the commissions. Sometimes he received none at all, but he cannot estimate how often this occurred. Moreover, we note that the normal commission (before splitting) was 5 per cent on events other than horse races, while in horse racing, although the normal commission was likewise 5 per cent, only the loser paid a commission. Petitioner was unable to estimate what proportion of the bets were on horse racing.

So far, however, we have discussed only layoff bets with out-of-town betting commissioners. Since such layoffs, when placed by petitioner, only occurred when he already had bets, but had not found a customer betting the other way to balance off his

risk, it is clear that he must have placed local bets (handled largely in cash) in totals at least as large as the total of layoff bets. (When out-of-town betting commissioners laid off bets with him, he conversely placed balancing bets with his own customers or other commissioners.) On the bets placed with his own customers, there was no splitting of commissions.

Even the above-described practices do not paint the full picture. A substantial part of his business was the placing of bets locally. Petitioner could not estimate the proportions of local to out-of-town business. Except in instances such as those described above, where he couldn't place balancing bets with his own customers, and laid them off with other commissions, he accepted bets from local customers and offset them substantially by placing balancing bets with other local customers who were willing to risk their money by betting the opposite way. Here, he received full commissions of 5 per cent from both parties (except that in horse race bets only the loser paid commissioners) and did not split them with anyone else. It is clear from the record that this was a large part of his business.

Occasionally, he was unable to collect from a loser, but this seldom happened, because, as he testified, he watched his credits closely.

We have given painstaking care to the foregoing. We fully realize that much is lacking. We have

reconciled and integrated the elements as best we can by the use of our own judgment. We conclude, with respect to 1948, that it is not likely that petitioner received gross commissions as betting commissioner in excess of $167,000, and that petitioner has failed to establish a lesser amount. From this, we subtract the gross income of $56,795.13 of the Kingston Club reported by petitioner in his income tax return, and we find a net understatement of income as betting commissioner for 1948 in the amount of $110,204.87.

Other items of income (including the small item of omitted interest) and deductions claimed by petitioner on his return are not in dispute.

Again we recognize that our finding of petitioner's net understatement of gross commissions as betting commissioner represents merely such an approximation as we may glean from the vague and meager record before us. To the extent that our approximation approaches accuracy, however, it necessarily gives indirect effect to the allowance of pay outs.

What we have said with respect to income as betting commissioner in 1948 applies in substance to 1949 as well, and we need not repeat our discussion in full. In 1949, the deposits in petitioner's commercial account totaled over $400,000. Of this amount, the cash deposits were only a little over $8,400. The remaining deposits were largely remittances from out-of-town betting commissioners. Un-

deposited checks which were either cashed or endorsed to others totaled over $107,000. Again, it appears that substantial checks were issued by petitioner, largely to other betting commissioners, in settlement of accounts where the net credits were in their favor. The amount of such checks is not established for 1949 but (as stated above with respect to 1948) the total checks in 1950 exceeded $290,000 and both parties appear satisfied that the same general pattern of payments by check existed in 1949. Here also the total of checks deposited, checks cashed or endorsed, and checks issued pictures a minimum of layoff bets since they represent in the main settlement of accounts arising out of more than one bet. Once more it is apparent that the total of the layoff bets must have materially exceeded such total. With respect to local bets, what we have said in relation to 1948 applies equally to 1949.

From all of the foregoing, we have concluded that it is not likely that petitioner received gross commissions in 1949 in excess of $145,000 and that petitioner has failed to establish a lesser amount. Subtracting gross income of $66,274.91 of the Kingston Club reported by petitioner in his income tax return, we find a net understatement of income as betting commissioner for 1949 in the amount of $78,725.09. What we have said concerning other income and expenses and also, with respect to indirect allowance of pay outs for 1948, applies to 1949 as well

The picture does not change in principle in 1950, and we need not repeat our earlier discussion. Deposits in petitioner's commercial bank account totaled over $283,000, of which about $13,950 was deposited in cash. Undeposited checks which were either cashed or endorsed to others totaled $22,613.75. Checks largely issued to other betting commissioners totaled in excess of $290,000. Again there was a settlement of accounts, so that the total layoff bets must have exceeded the total of checks deposited, checks cashed or endorsed, and checks issued to betting commissioners. What we have said about local bets again applies to 1950.

As to 1950, we have concluded that it is not likely that petitioner received gross commissions in excess of $108,000 and that petitioner has failed to establish a lesser amount. Subtracting therefrom gross income from business in the amount of $8,207.71 reported by petitioner in his amended income tax return for 1950, we find a net understatement of income as betting commissioner for 1950 in the amount of $99,792.29. What we have said with respect to other income and expenses, and indirect allowance of pay outs for 1948 and 1949 applies also to 1950.

The gross income and understatements determined by us with respect to petitioner's activities as betting commissioner for each of the years in question include any income or loss from the Kingston Club card room. No separate income or loss

from the card room operation has been reliably established.

Petitioner's counsel argue on brief that petitioner, as a well known betting commissioner, was in a sense a trustee for the betting public, that his character is unblemished, his veracity not open to question and that his credibility is in no sense affected by the fact that he was engaged in an illegal business. It is argued, therefore, that we should accept his testimony that his returns as prepared for him by his accountant, were true, correct and honest, leading to the conclusion that we should find no deficiencies. We see no occasion to discuss the validity of the tradition of the honest gambler or whether, if valid, it extends to reporting of income for tax purposes. As will appear from our discussion infra, we think it is clear from the record that petitioner had substantial income in each of the years in question in excess of what he reported, and that he was well aware of it.

The data for petitioner's income tax returns for the years in question was prepared by the accountant Murton or under his direction by someone in his organization. The information, when assembled, was turned over to the accountant Calegari, who prepared the returns. The method of determining net income was described by the witness Evje (an accountant in Murton's organization) as follows:

> The method used to arrive at what we will say is net income was to take—we had already itemized all deductible expenses. We take the

beginning bank balance and subtract it from the ending bank balance, adding to that any personal withdrawals, all of these expenses as itemized, and the difference between the beginning and the ending were these adjustments which would constitute gross income. From this would be deducted this summary as submitted in evidence here to arrive at net income from the operations of the Kingston Club.

Petitioner testified that he maintained a cash revolving fund of about $3,000. He stated that if the amount in the fund was depleted, he added cash. If it increased to an amount substantially over $3,000, petitioner testified that the excess was deposited in his commercial bank account. Murton completely disregarded cash on the theory that the revolving fund was kept at approximately $3,000 and that any excess cash was deposited in the bank, and, therefore, reflected in Murton's calculation. Petitioner never furnished to Murton any information as to the amount of cash bets placed, cash receipts, cash disbursements, or cash commissions.

It is clear from the record that a large part of petitioner's business was local, and that, in the main, the local transactions were settled in cash. The commissions on such local business were likewise received in cash or deducted from cash payments when settlements were made. There is no specific evidence in the record as to the amount of local bets placed by petitioner, but we think a con-

servative estimate may be inferred from correlation with the amount of bets laid off with out-of-town betting commissioners. Bets were laid off with out-of-town commissioners largely when petitioner could not cover them locally. The transactions with out-of-town betting commissioners were largely by check or money order. Petitioner received or paid checks depending upon whether the net credit was in the hands of the out-of-town betting commissioner or in his own hands. The checks or money orders were largely in settlement of accounts, and represented the net from total bets in excess of the amounts actually remitted. The record contains evidence of petitioner's total deposits, cash deposits, undeposited checks and checks issued by him to bettors. (The figure for checks issued is available only for 1950, but both parties suggest in their proposed findings that the same pattern existed in 1948 and 1949, in each of which years the deposits and undeposited checks exceeded those in 1950.) We think the foregoing furnishes a basis for an estimate or approximation of total out-of-town bets. As a corollary, it furnishes a basis for approximating local bets. Out-of-town bets were largely layoffs, which presupposes local bets of relatively the same total. Moreover, there were substantial local bets which were laid off locally, either with in-town customers or betting commisioners in the area.

Keeping the above factors in mind, we think the record supports the inference (after due consid-

eration of the variations in commissions which we have already discussed) that petitioner received commissions from local bets in amounts not less than the following: 1948, $69,000; 1949, $60,000; 1950, $44,000. Nevertheless, despite the fact that local bets were largely settled in cash, the total cash deposits in petitioner's commercial bank account for the entire three years were less than $25,000, the amounts per year being approximately as follows: 1948, $430; 1949, $8,470; 1950, $13,955. We think it apparent upon consideration of all of the circumstances that large amounts of cash commissions in each of the years in question were not deposited in the bank and could not have been reflected in Murton's figures which disregarded cash or in petitioner's income tax returns based on Murton's data.

It is no answer to suggest that all cash receipts (including cash commissions) were used for pay outs. Petitioner himself testified that he broke about even as a result of the few occasions on which he acted as bookmaker. He testified that the occasions on which he failed to collect from losers were likewise few (except for losses totaling about $25,000 from failure to collect from two losing bettors in 1950) because he watched his credits closely. Except under these two circumstances, he did not shoulder the risk of the bet. His method of doing business necessarily resulted in an excess of total receipts over total pay outs, and the volume of his business, inferable from the record, and the

rate of commissions (allowing for the variations which we have already recognized) were such that his total commissions for each year involved greatly exceeded those reported. Since the total commissions were obviously not reflected in his commercial bank account, the inference is clear that they were received and retained in cash. It is to be recalled also that in each of the years in question, petitioner "received and endorsed" a substantial total of checks which he did not deposit.

Calegari's "Report on Lesly Cohen, January 1, 1948, to December 31, 1950," has the same defect as Murton's figures. Calegari, too, totally disregarded cash, in order to be consistent, (as he testified) with Murton. Calegari's calculation of net income is substantially based upon the same principles as those applied by Murton, except that Calegari eliminated from deductions certain personal expenditures which Murton had not found. Calegari's net worth statement likewise disregards the factor of cash on hand as of the beginning and ending of the net worth periods. By the same token, because the facts were not presented to him, he did not and could not take into consideration annual increases in cash attributable to cash commissions. See Miller v. Commissioner, 237 F. 2d 830 (C.A. 5, 1956), affirming in part a Memorandum Opinion of this Court.

However well intentioned, it is obvious that the calculations of Murton and Calegari do not establish petitioner's actual income as betting commis-

sioner for any of the years in question, and are in no sense an answer to the conclusion we have reached supra that petitioner received substantial commissions in each of the years in question which were not reported in his income tax returns.

Much is made of the fact that a prior examination made by Revenue Agent Parenti did not develop any substantial omissions of income. We think this to be of no significance. Parenti was making a routine examination and relied upon records from Murton's office. Murton himself was unaware of the income from cash commissions. Parenti's examination and report were in no sense binding on respondent.

Fraud

We next consider the question of whether or not a part of the deficiency for each of the years 1948, 1949 and 1950 was due to fraud with intent to evade tax within the meaning of section 293(b). The burden of proof with respect to fraud is upon the respondent, and he must establish fraud on the part of petitioner by clear and convincing evidence. Arlette Coat Co., 14 T.C. 751 (1950).

It should be noted at the outset that our conclusions in these respects must be based upon consideration of the entire record properly before us, and that we are not limited to a consideration of respondent's affirmative evidence. Frank Imburgia, 22 T.C. 1002 (1954); Wallace H. Pettit, 10 T.C. 1253 (1948); L. Schepp Co., 25 B.T.A. 419 (1932).

We also recognize that in this, as in many fraud cases, the proof of fraud, if it is to be established, must depend in some respects upon circumstantial evidence. Fraudulent intent can seldom be established by a single act or by direct proof of the taxpayer's intention. It is usually found by surveying his whole course of conduct and is to be adduced as any other fact from all the evidence of record and inferences properly to be drawn therefrom. M. Rea Gano, 19 B.T.A. 518 (1930).

Our finding of an understatement in taxable income for each of the years for the purposes of the deficiencies involved was based in some respects upon petitioner's failure to meet his burden of proof. We recognize that respondent cannot meet his own burden of establishing fraud on the basis of petitioner's failure to discharge the burden of proving error in the determination of deficiencies, and we do not, of course, rest our finding of fraud on that basis. The existence of fraud with intent to evade tax must be affirmatively established by respondent. Kurnick v. Commissioner, 232 F. 2d 678 (C. A. 6, 1956); Drieborg v. Commissioner, 225 F. 2d 216 (C.A. 6, 1955), affirming in part a Memorandum Opinion of this Court.

After a painstaking analysis of all of the evidence in this case, and bearing in mind the above-stated principles, we are convinced that petitioner received taxable income during each of the years 1948, 1949 and 1950 from his activities as betting commissioner in excess of that reported on his re-

turns for those years, and that in each of said years a part of the deficiency was due to fraud with intent to evade taxes. It is well settled that respondent, in sustaining his burden of proof of fraud, need not prove the precise amount of the deficiency attributable to such fraud, but only that a part of the deficiency is attributable thereto. United States v. Chapman, 168 F. 2d 997 (C.A. 7, 1948), certiorari denied 335 U.S. 853.

Taking into consideration the minimum volume of layoff bets indicated by the deposit of checks and money orders from out-of-town betting commissioners; undeposited checks and money orders from the same sources; checks of petitioner to betting commissioners; the fact that the remittances to and from petitioner usually represented the settling of accounts rather than individual bets; the added fact that petitioner's local cash business was a substantial part of his betting commissioner activities, recognizing the percentages he received (and making allowance for splitting of commissions on out-of-town business, occasional foregoing of commissions, occasional losses, and the fact that petitioner received commissions on horse race bets only from the loser), we reach the conclusion that there was a substantial understatement of income on petitioner's return for each of the taxable years in question. We cannot, on the record before us, determine the precise amount of such understatements, and we are not required to do so. However, after resolving any doubts in this

respect against respondent, with whom the burden of proof of fraud lies, we hold, upon our analysis of the record, that the understatements were substantial for each year before us. Our analysis likewise convinces us that a large part of the understatements in each of said years was attributable to petitioner's failure to include in his return the receipt of commissions in cash.

In the light of the foregoing, we, of course, reject petitioner's testimony to the effect that his returns were honest, correct and complete because analysis of the record demonstrates the contrary. The testimony of his accountants does not lead to a different view. They being uninformed of the full facts relating to cash transactions, could not reflect income undisclosed to them in preparing his returns.

Consistent understatement of income in substantial proportions is in itself persuasive evidence of fraudulent intent to evade taxes. Rogers v. Commissioner, 111 F. 2d 987 (C.A. 6, 1940), affirming 38 B.T.A. 16; Drieborg v. Commissioner, supra; Bryan v. Commissioner, 209 F. 2d 822, 828 (C.A. 5, 1954), certiorari denied 348 U.S. 912. Here, in addition, petitioner failed to maintain records of his cash transactions, or of the cash commissions earned in such transactions, and kept uninformed the accountants whom he employed to prepare the data for his returns and the returns themselves. Petitioner admits that his failure to maintain rec-

ords of his transactions as betting commissioner was deliberate. The reason he assigns was to keep them from law enforcement officers on the lookout for illegal gambling activities. We have no doubt that concealment from the tax authorities and evasion of taxes was a co-ordinate objective. If this were not so, he could readily have kept sufficient records to supply his accountants with information as to his earnings so that his income tax returns would have reflected his true income even though such records did not include the names of his customers and the other betting commissioners with whom he dealt. Petitioner was an educated man and could not have been unaware of his obligations as a taxpayer. We need not labor the question of whether or not Murton told petitioner that the internal revenue officer in San Francisco had advised him by letter that his accounting method was adequate for income tax purposes. Assuming that a responsible revenue official would write such a letter (which we doubt), there is nothing in the evidence to the effect that the tax authorities or Murton ever advised petitioner that it was not necessary for him to disclose to Murton the full amount of his commissions, or report them in his income tax returns.

We think it clear, without going into further detail, that fraudulent intent to evade taxes must be inferred from petitioner's conduct as disclosed by the record. The Supreme Court had occasion to consider the problem of inference of fraud from

conduct in Spies v. United States, 317 U.S. 492 (1943), and said, in this connection (p. 499):

> By way of illustration, and not by way of limitation, we would think affirmative wilful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal. If the tax-evasion motive plays any part in such conduct the offense may be made out even though the conduct may also serve other purposes such as concealment of other crime. [Emphasis supplied.]

Upon the entire record, therefore, we hold that respondent has met his burden of proving that there was a deficiency for each year in question due at least in part to fraud with intent to evade tax, and that additions to tax under section 293(b) are to be applied for each of said years.

Decision will be entered under Rule 50.

Filed: September 12, 1957.

Entered: September 12, 1957.

Served: September 12, 1957.

Tax Court of the United States
Washington

Docket No. 46719

LESLY COHEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion filed September 12, 1957, having filed an agreed computation of the tax, it is

Ordered and Decided: That there are deficiencies in income tax and additions to tax as follows:

Years	Deficiency	Additions to Tax Under Section 293(b), I.R.C., 1939
1948	$72,164.36	$38,835.02
1949	$47,364.77	$27,790.00
1950	$49,004.79	$24,502.40

[Seal] /s/ MORTON P. FISHER,
Judge.

Served: December 12, 1957.

Entered: December 12, 1957.

United States Court of Appeals,
Ninth Circuit

Tax Court Docket No. 46719

LESLY COHEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Review of Decision of the Tax Court of the United States by the United States Court of Appeals for the Ninth Circuit

To: The Honorable, the Judges of the United States Court of Appeals for the Ninth Circuit:

I. Jurisdiction:

On the 9th day of December, 1957, the Tax Court of the United States entered its decision in this case, Tax Court Docket No. 46719, setting up deficiencies of income tax against the petitioner Lesly Cohen for the year 1948 in the sum of $72,-164.36 with additions to tax under Section 293(b) IRC 1939 in the sum of $38,835.02, and for the year 1949 it set up a deficiency in income tax of $47,-364.77 with additions in tax under Section 293(b) IRC 1939 in the sum of $27,790.00, and for the year 1950 it set up deficiency in income tax of $49,-004.79 and additions to tax under Section 293(b) IRC 1939 in the sum of $24,502.40.

The petitioner duly filed his income tax returns for the years involved with the Collector of Internal Revenue at San Francisco, California, which is located within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, and during all the period involved was a resident of San Francisco, California, but is now a resident of Las Vegas, Nevada.

The jurisdiction of this Court to review the decision of the Tax Court of the United States, as aforesaid, is found in Sections 7482 and 7483 of the Internal Revenue Code of 1954.

II. Nature of the Controversy:

The nature of the controversy before the Tax Court of the United States is the determination of the income taxes of the petitioner for the calendar years 1948, 1949 and 1950 together with additions to the tax under Section 293(b) of the Internal Revenue Code 1939 and, in particular, (a) whether the respondent's use of the bank deposit method was justified, (b) whether certain losses incurred in taxpayer's dealings as a betting commissioner with the Film Row Club were deductible in full, (c) whether, and to what extent, petitioner omitted taxable income from his returns for each of the years 1948, 1949 and 1950; and (d) whether if there was any additional income for each of the years in question, any part of the deficiency was due to fraud.

1. Petitioner is an individual whose business office during the years in question was located at San Francisco, California. Petitioner was on the cash basis of accounting and filed his income tax returns for the years 1948, 1949 and 1950, respectively, with the Collector of Internal Revenue for the First District of California at San Francisco, California.

2. Throughout the years in question the petitioner operated a cardroom and betting commissioner business. The operations of the cardroom were not in controversy in this case. The commission petitioner received on the bets handled for his own customers was 5% on each bet handled by him, except that on horse racing bets only the loser paid a commission. These commissions were not split. On bets laid off with other betting commissioners, the commission was usually split, half going to petitioner. At times, he found it necessary to waive his entire commission in order to get the bets laid off with another betting commissioner.

3. The respondent's deficiency notice, dated November 25, 1952, proposed two additions to income for the year 1948. (a) "Interest $159.12 which is stated to be interest received on a refund of Federal income tax which was not included in income as reported." This item was not at issue in the Tax Court, nor is it an issue here. (b) Business income $693,189.62. For the year 1949 the only item in this statement is: "(a) Business income $542,478.73." For the year 1950 the statement includes the fol-

lowing: "(a) Business income $326,095.00." The Revenue Agent testified that the sums designated in the deficiency letter as additional business income were made up from three sources:

(a) The total bank deposits included both cash and checks;

(b) The sum of a considerable number of checks which had been cashed by petitioner or endorsed by him to other parties instead of deposited in the bank account;

(c) He added to the above sums the wins from the Film Row Club;

(d) He did not allow any of the losses shown on the books of the Film Row Club from which he took the winnings.

There is no evidence in the record that would indicate the Film Row Club transactions were personal bets of the petitioner.

4. The petitioner's accountant died in the year 1950 and petitioner was unable to locate his checks and bank statements. However, Mr. Parenti, a Revenue Agent, had previously checked and audited the petitioner for the years 1948 and 1949 and all the petitioner's bank statements and canceled checks were available to Mr. Parenti at the time. Mr. Parenti issued a Revenue Agent's Report which shows several adjustments to petitioner's income tax return, but at no time did he question the adequacy of the method of accounting employed by Mr. Merton, petitioner's accountant.

III. Assignment of Errors:

In making its decision, as aforesaid, the Tax Court of the United States committed the following errors upon which your petitioner relies as a basis of this proceeding:

1. The Tax Court erred in holding that any deficiency exists with respect to petitioner's personal income tax for the taxable years ended December 31, 1948, December 31, 1949 and/or December 31, 1950, except a small deficiency for interest received on an income tax refund in the sum of $159.12 in the year 1948. There is no evidence in the record to sustain the findings of the Tax Court that petitioner understated his income for the years involved.

2. The Tax Court erred in holding that any part of the deficiency for each of the years in question was due to fraud with intent to evade taxes.

3. The Tax Court erred in refusing to follow the determination of Revenue Agent Parenti in his audit for the years 1948 and 1949 when the Revenue Agent had available all the checks, bank accounts and records of the petitioner.

4. The Tax Court erred in refusing to hold that the determination of the deficiencies for each of the years was arbitrary, illegal and void in view of the fact that the petitioner proved his net worth statement and the respondent introduced no evidence showing that there was error in the net worth

statement presented to it, and there was no evidence to support the deficiency letter's findings and no contradiction of the taxpayer's evidence that he reported all his income.

5. The Tax Court erred in not allowing the full losses of the Commissioner's activities as a betting commissioner in the Film Row matter.

6. The Tax Court erred in refusing to accept the long established method of accounting used by the taxpayer's accountant when it had been audited not only by the agent Parenti, but by previous Internal Revenue auditors and no objection had been made to the taxpayer of his method of accounting.

Wherefore, your petitioner prays that this Honorable Court may review the decision and order of the Tax Court of the United States in this cause and reverse and set aside the same, and to direct the Tax Court to determine and enter an order on such determinations there is no deficiency in the payment of income tax for the taxable year ended December 31, 1948, except on the basis that there should be an addition to income and the deficiency determined on the sum of $159.12 of interest unreported; that there is no deficiency in the payment of income tax for the taxable year ended December 31, 1949; that there is no deficiency in payment of income tax for the taxable year ended December 31, 1950; that there is no evidence to support the Tax Court's finding of an intent to evade or defraud the revenues of the United States; and for

the entry of said other decisions and orders, and such other and further relief as shall appear proper in the premises.

Dated: March 3, 1958.

/s/ CLYDE C. SHERWOOD,

/s/ JOHN V. LEWIS,
Attorneys for Petitioner.

Received and filed March 4, 1958, T.C.U.S.

[Title of Tax Court and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Commissioner of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

Nelson P. Rose, Attorney for Respondent,
Chief Counsel, Bureau of Internal Revenue,
Internal Revenue Building, Washington, D. C.

You Are Hereby Notified that on the 4th day of March, 1958, a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled cause, was filed with the Clerk of the Court. A copy of the petition as filed is attached hereto and served upon you.

Dated: March 6th, 1958.

/s/ CLYDE C. SHERWOOD,

/s/ JOHN V. LEWIS,

Attorneys for Petitioner.

Service of copy acknowledged.

Received and Filed March 10, 1958, T.C.U.S.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is stipulated that the following facts may be received in evidence without further proof; provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts stipulated; and provided, further, that both parties to this stipulation reserve the right to object to the materiality and relevancy of any of the facts herein stipulated.

1. The petitioner is and was throughout the years in controversy herein a single individual. The returns for the periods here involved were filed with the Collector for the First Collection District of California.

2. For each of the taxable years involved, petitioner filed his income tax return on the calendar year and cash basis. Attached hereto and marked with the exhibit numbers as indicated are copies of

the income tax returns filed by the petitioner for said years:

Ex. 1-A—1948 return.
Ex. 2-B—1949 return.
Ex. 3-C—1950 return.
Ex. 4-D—1950 amended return, filed July 28, 1954.

3. During the years 1948, 1949 and 1950 petitioner owned and operated as sole proprietor an establishment known as the Kingston Club, which said Kingston Club was located at 111 Ellis Street, San Francisco, California.

4. Throughout the years 1948, 1949, and 1950, the petitioner maintained a commercial account in the name of "Les Cohen" at the Market-Ellis branch of the Anglo-California National Bank, San Francisco, California. Attached here to and marked Exhibit 5-E is a summary of the deposits to said account during said years prepared from the deposit slips on file with the bank, except for the month of November, 1949, for which no deposit slips could be located. The first column on said summary shows the date of the deposit, the second column shows the number of items that made up the deposit; the third column shows the amount of cash, if any, included in said deposit, and each pair of columns thereafter shows the bank reference number and the amount of each check deposited.

5. The total deposits to petitioner's commercial account in the Market-Ellis branch of the Anglo-

California National Bank for each of the years 1948, 1949, and 1950, were in the following amounts:

1948	$508,384.23
1949	$404,118.69
1950	$283,129.80

Deposits totalling $2,905.00 were made to said account on January 3, 1951.

6. During the years in controversy the petitioner received and endorsed checks issued to "Les Cohen" by "The Horse Shoe," 1047 Third Avenue, Seattle, Washington. Attached here to and marked Exhibit F is a list showing said checks.

7. During the years in controversy the petitioner received and endorsed checks issued to "Les Cohen" by "Nationwide Sport Service," 314 South Broadway, Portland, Oregon. Attached hereto and marked Exhibit G is a list of said checks.

8. During the years in controversy the petitioner received and endorsed checks issued to "Les Cohen" drawn on the United States National Bank of Portland and signed "A.A.F.F. Account by Geo. Storey." Attached hereto and marked Exhibit H is a list of said checks.

9. During the years 1948 and 1949 the petitioner endorsed checks drawn on the National Safety Bank and Trust Company of New York and issued by Abraham Abrams. Attached hereto and marked Exhibit I is a list showing said checks.

10. Because of revision there is no Exhibit J.

11. During the years 1948 and 1949 the petitioner received and endorsed checks drawn on the Bank of America, San Diego, California, and issued by Herman Hetzel. Attached hereto and marked Exhibit K is a list of said checks.

12. During the year 1948 the petitioner received and endorsed two checks drawn on the Bank of America, Beverly-Vernon branch, Los Angeles, issued by Clyde Baxter. Said checks were dated February 24, 1948, and May 3, 1948, and were in the amounts of $4,391.25 and $8,415.00, respectively.

13. During the years in controversy the petitioner received and endorsed checks drawn on the Mississippi Valley Trust Co., St. Louis, Missouri, and issued by M. L. Cooper & Co. Attached hereto and marked Exhibit L is a list of said checks.

14. During the years in controversy the petitioner received and endorsed checks drawn on the First National Bank of Chicago, Chicago, Illinois, issued by Edward M. Dobkin & Co. Attached hereto and marked Exhibit M is a list of said checks.

15. During the years 1948 and 1949 the petitioner received and endorsed checks drawn on the Bank of America, South Hollywood branch, Los Angeles, California, issued by Hymie Miller. Attached hereto and marked Exhibit N is a list of said checks.

16. During the year 1948 the petitioner received and endorsed checks drawn on the Stockton Savings & Loan Bank, Stockton, California, issued

by Raymond E. Kelliher. Attached hereto and marked Exhibit O is a list of said checks.

17. During the years 1948 and 1949 the petitioner received and endorsed checks drawn on The LaSalle National Bank, Chicago, Illinois, issued by Mal Clarke & Co. Attached hereto and marked Exhibit P is a list of said checks.

18. During the years in controversy the petitioner received and endorsed checks drawn on The First National Bank of Portland, Oregon, issued by Irving J. Hasson. Attached hereto and marked Exhibit Q is a list of said checks.

19. The petitioner received payments in the amounts of $55.00 and $2,475.00 by bank drafts dated June 1, 1948, and August 30, 1948, respectively, from Barrick, Weyerman, and Ziegman, doing business as "Baseball Headquarters," Omaha, Nebraska.

20. During the years 1948 and 1949 the petitioner received and endorsed checks issued by Lee Jones, Jr., of San Francisco, California. Said checks were dated and in amounts as follows:

January 13, 1948	$1,000.00
May 17, 1949	$500.00
June 27, 1949	$335.00
August 31, 1949	$116.00

21. Attached hereto and marked Exhibit R is a schedule showing, by years, the total amounts of the checks referred to in paragraphs 6 through 20,

supra, and showing in a column headed "Deposited" the total amounts of said checks which were deposited in petitioner's commercial account at the Market-Ellis branch of the Anglo-California National Bank, San Francisco, California, and showing in a column headed "Not Deposited" the total amounts of said checks which were not so deposited.

/s/ JOHN V. LEWIS,
Counsel for Petitioner.

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

Filed March 28, 1956, T.C.U.S.

[Title of Tax Court and Cause.]

DOCKET ENTRIES

1953

Feb. 2—Petition received and filed. Taxpayer notified. Fee paid.

Feb. 3—Copy of petition served on General Counsel.

Mar. 31—Answer filed by General Counsel.

Mar. 31—Request for hearing in San Francisco, Calif., filed by General Counsel.

Apr. 6—Notice issued placing proceeding on San Francisco, Calif., calendar. Service of Answer and Request made.

1953

May 12—Reply to Answer filed by taxpayer. Copy served 5/13/53.

1955

Dec. 21—Hearing set Mar. 26, 1956 — San Francisco, Calif.

Dec. 22—Revised notice as to spelling of Petitioner's last name, filed.

1956

Mar. 28—Hearing had before Judge Fisher on the merits, Stipulation of Facts, filed at hearing, Petitioner's Brief due 5/28/56; Respondent's Brief due 7/27/56; Petitioner's Reply due 8/27/56.

Apr. 5—Transcript of Hearing 3/28/56 filed.

May 25—Petitioner's Brief filed. 5/28/56 served.

July 27—Respondent's Brief filed. 7/30/56 served.

Aug. 16—Motion for extension of time to 9/27/56 to file reply brief, filed by Petitioner. 8/16/56 —Granted.

Sept. 27—Petitioner's Reply Brief, filed. 9/27/56 served.

Oct. 16—Motion for leave to file memorandum, memorandum concerning new matter in Petitioner's reply brief lodged, filed by Respondent.

Oct. 18—Motion for leave to file memorandum Granted, memorandum concerning new matter in petitioner's reply brief, filed by Respondent. Served 10/22/56.

1957

Sept. 12—Memorandum sur order in re motion to strike evidence, filed.

Sept. 12—Memorandum findings of fact and opinion rendered, Judge Fisher. Decision will be entered under Rule 50. Served 9/12/57.

Nov. 20—Respondent's computation filed.

Nov. 25—Notice of hearing Feb. 5, 1956, Wash., D. C. Served 11/26/57.

Dec. 3—Agreed computation filed.

Dec. 9—Decision entered, Judge Fisher. Served 12/12/57.

1958

Mar. 4—Petition for Review by U. S. Court of Appeals, 9th Circuit, filed by petitioner.

Mar. 10—Notice of filing petition for review with proof of service thereon filed.

Mar. 10—Designation of the portions of record, proceedings and evidence to be contained in the record on appeal with proof of service thereon, filed.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Ralph A. Starnes, Chief Deputy Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 12, inclusive, constitute and are all of the original papers as called for by the "Designation of the Portions of

record, proceedings and evidence to be Contained in the Record on Appeal," excepting the exhibits which are separately certified, in the case before the Tax Court of the United States docketed at the above number and in which the petitioner in the Tax Court has filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 25th day of March, 1958.

[Seal] /s/ RALPH A. NORMAN,
Chief Deputy Clerk, Tax
Court of the United States.

[Endorsed]: No. 15982. United States Court of Appeals for the Ninth Circuit. Lesly Cohen, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: April 8, 1958.

Docketed: April 15, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

No. 15,982

United States Court of Appeals

For the Ninth Circuit

LESLY COHEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S OPENING BRIEF.

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
1102 Central Tower,
San Francisco 3, California,
Attorneys for Petitioner.

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No. 15,982

United States Court of Appeals

For the Ninth Circuit

LESLY COHEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S OPENING BRIEF.

OPINION OF THE TAX COURT.

The opinion of the Tax Court is printed in 1957 (P-H) T.C. Memo. Dec. Par. 57.172 and is set forth in the Transcript of Record,* pages 206-248.

JURISDICTION OF THE COURT.

The Petitioner has petitioned this Court for review of the decision of the Tax Court of the United States, entered December 12, 1957, in accordance with its findings of fact and memorandum opinion promul-

*Unless otherwise stated all page references are to the Transcript of Record.

gated September 12, 1957, and reported in 1957 (P-H) T.C. Memo. Dec. Par. 57,172. The case involves liability for income taxes for the years 1948, 1949, and 1950, and the Petitioner's income tax returns for those years were filed with the Collector of Internal Revenue in San Francisco, which is located within the Ninth Circuit. This Court has jurisdiction to hear this petition for review under the provisions of Section 1141 of the Internal Revenue Code.

STATUTES INVOLVED.

Internal Revenue Code (1939):

Sec. 22.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Internal Revenue Code (1939):

Sec. 1112.

Fraud.—In any proceeding involving the issue whether the Petitioner has been guilty of fraud

with intent to evade the tax, the burden of proof in respect of such issue shall be upon the Commissioner.

STATEMENT OF THE CASE.

The findings of fact by the Tax Court are set forth here in full. We have inserted brackets around those findings to which the Petitioner takes exception.

"Petitioner, Lesly Cohen, during the taxable years in controversy herein, resided in San Francisco, California, and was unmarried. Petitioner filed his individual tax returns for the calendar years 1948 through 1950, inclusive, on a cash basis with the then Collector of Internal Revenue for the First District of San Francisco, California.

"Lesly was born and educated in San Francisco. He worked on a local newspaper, the San Francisco Bulletin, as a copy boy, and eventually became a sports writer and member of the sports staff. About 1934, when the Bulletin was sold to another publisher, Petitioner became a free-lance writer on sports subjects, editing boxing magazines and doing publicity work for various athletic events.

"During the taxable years in question, Petitioner lived modestly in his mother's home with two brothers and two sisters.

"During World War II, Lesly was inducted into the United States Army. Upon his discharge, he returned to California and soon thereafter became ac-

quainted with Coplin, who owned and operated the Kingston Club, (111 Ellis Street) in San Francisco. A 'card room' was maintained as part of the club's operations. The same premises were used by Coplin for his 'betting commissioner' business, which consisted largely of placing bets on horse races on a commissioner basis. The latter venture was in violation of both State and local law. Coplin, desirous of expanding his gambling activities to embrace other athletic events, invited Petitioner to join his betting commissioner enterprise as a limited partner.

"In the latter part of 1947, Coplin died, and about January 1948, Lesly took over the operation of the Kingston Club. Thereafter, until the latter part of 1951, when the Federal Gambling Stamp Tax law was put into effect, Lesly operated the club's card room and betting commissioner activities as sole proprietor. During the years 1948, 1949 and 1950, Lesly's activities as betting commissioner included not only horse racing, but other sports events. He was unable to estimate what proportion of the bets handled by him grew out of horse racing and what out of other sports events. Petitioner's activities as betting comissioner, and his operation of the card room were his only income-producing activities during the years in question, other than a small amount of income derived from investments in securities with his brother Herbert. [In his personal gambling activity at the Film Row Club, his losses exceeded his gains.] The gains and losses from his limited activities as bookmaker about balanced each other.

"Petitioner's primary function as betting commissioner was to obtain opposite parties to a wager, receiving for his services a 'commission' or fixed percentage of the amount involved in the wager. Ordinarily, Lesly would quote prevailing odds on horse races and other athletic events and if a customer wished to make a wager, Petitioner would attempt to locate others to accept or 'cover the bet' in the same amount. Normally, Petitioner did not accept a wager as 'placed' until he had found some other individual to 'lay off' the other side of the same event. When Petitioner was able to 'lay off' the entire amount of the bet, Petitioner's profit or loss would not depend upon the outcome of the event, but would be a fixed percentage or 'commission' of the total wager, which Petitioner retained on each bet. When able to do so, Petitioner would lay off the bet with one or more of his own local customers. When this could not be accomplished, he would lay off or cover the bet with other betting commissioners in the San Francisco Bay area and in other cities. He would not bring the customers betting on opposite sides of the same transaction into personal contact so that they could bet with each other. When Lesly located a client willing to accept the other side of a bet, he would confirm acceptance of the wager by telephone. Lesly was personally responsible for the collection of all betting commitments which he made, and had to pay the winner even if he was unable to collect from the loser. Petitioner watched his credits closely.

"The commission to Petitioner on bets handled for his own customers was five per cent on each bet

handled by him, except that on horse racing bets only the loser paid a commission. These commissions were not split. On bets laid off with other betting commissioners, the commission was usually split, half going to Petitioner. At times, he found it necessary to waive his entire commission in order to get the bet laid off with another betting commissioner.

"Occasionally, through miscalculations on Petitioner's part, or other unforeseen circumstances, he accepted a bet and could not arrange to lay it off. He then found it necessary to carry the other part of the bet. On these occasions, he acted as bookmaker to the extent that he himself carried the bet. Except for such occasional instances, he did not carry any part of the bet himself.

"Petitioner's betting commissioner enterprise was operated almost entirely on a credit basis. Comparatively insubstantial amounts of money were actually posted with Petitioner prior to the happening of the event which determined the wager. Normally Petitioner collected cash from local bettors and paid local winners in cash. Cash settlements were made with local customers following the happening of the sporting event. Settlements with other commissioners in the San Francisco area were likewise mainly in cash. Transactions with out-of-town betting commissioners were generally settled at periodic intervals by check. The periods varied, and included settlements on a daily, weekly or monthly basis, or when the account reached a certain fixed sum in favor of Petitioner or the out-of-town broker. Such settlements were in ef-

fect the balancing of accounts between Petitioner and out-of-town betting commissioners. They usually represented the net amount due from a number of bets rather than a single bet. When it was necessary for Petitioner to remit to an out-of-town broker to settle an account, Petitioner usually sent his own personal check. Occasionally he was required to send cashier's checks. Petitioner was unable to estimate what proportion of his betting commissioner transactions were with out-of-town brokers. The handling of bets of local customers as betting commissioner on a commission basis was a substantial part of Petitioner's business.

"Petitioner maintained a 'revolving fund' of about $3,000.00 in cash, which he used in making pay outs to local winners. Checks, most of which were received from out-of-town brokers, were either deposited in Petitioner's commercial bank account or were endorsed and transferred, or cashed by Petitioner. The only cash deposits in Petitioner's commercial bank account during the years in question were, in the aggregate, as follows: 1948—$430; 1949—$8,470; 1950—$13,955. Petitioner received cash from local bettors far in excess of the foregoing amounts in each of said respective years. His records of cash transactions as betting commissioner were kept only a few days until settlement was made. He never furnished to his accountant any records of his cash transactions or cash commissions received as betting commissioner. In preparing data for Petitioner's income tax returns for the years in question, neither the accountant

who assembled the data nor the accountant who prepared the returns from said data took into consideration any undeposited cash.

"Throughout the years 1948, 1949 and 1950, Petitioner maintained a commercial bank account in the name of 'Les Cohen' at the Market-Ellis Branch of the Anglo-California National Bank, San Francisco, California, where he deposited funds relating primarily to his activities as betting commissioner. The total deposits to Petitioner's commercial account in said bank for each of the years involved herein were in the following amounts:

Year	Amount
1948	$508,384.23
1949	404,118.69
1950	283,129.80

"Said deposits largely represented receipts from other betting commissioners in settlement of accounts.

"The foregoing deposits consisted almost entirely of checks. During the entire three-year period in question the total amount of cash included in said deposits (detailed *supra* by years) was less than $25,000.00. Deposits totaling $2,905 were made to said account on January 3, 1951.

"During each of the years in controversy, Petitioner received a large number of checks payable to 'Les Cohen' which were endorsed by him but not deposited. The total amounts thereof and the respective years in which received were as follows: 1948—$120,974.75; 1949—$107,712; 1950—$22,613.75. These undeposited

checks likewise largely represented settlement of accounts.

"Petitioner made payments by check in the settlement of accounts with out-of-town bettors totaling $292,283.46 in the year 1950.[1]

"During the taxable years in question, Petitioner did not maintain any permanent or detailed records or formal books reflecting gross commissions or gross receipts and disbursements from his betting commissioner activities. Petitioner was apprehensive that the possession of such records would be both incriminating to him and embarrassing to his customers if they fell into the hands of law enforcement officers. For his own reference purposes, however, he kept a daily 'master sheet' at the Kingston Club setting forth the transactions which he handled as betting commissioner. On a busy day, approximately 100 wagers were recorded thereon. After a day or two, when the master sheets had served their immediate purpose, they were destroyed to avoid possible seizure and use as evidence by police authorities. The effect of such destruction was likewise to render it impossible to make an accurate determination of the amount of his commissions received as betting commissioner. No record of such commissions was maintained by Petitioner.

"Petitioner retained George T. Murton (formerly the accountant for the Kingston Club during the years

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[1]Petitioner, in his proposed Finding No. 50, and Respondent, in his proposed Finding No. 83, take the position in effect that payments in unspecified amounts were made under similar circumstances in 1948 and 1949.

Coplin operated the club) to maintain its records, and Murton, or Evje, an accountant in Murton's firm, performed such service for Petitioner during the years in question.

"Murton's procedure was to go to the Kingston Club at least once a month and take off the record of income and disbursements from the card room. He also collected memorandum sheets upon which the Petitioner had noted daily cash expenditures. Receipts or paid bills were usually attached.

"Murton took the bank statements and cancelled checks and reconciled the bank statements with the check book stubs.

"The books of account of the card room were either used at the card room by Murton or taken to his office and returned to the card room where they were kept.

"The bank statements, cancelled checks, and memoranda of cash expenditures were kept by Murton either at his home or in his office.

"Murton compiled the results of his accounting work in a so-called ledger which was actually a compilation on columnar work sheets.

"Murton's method of arriving at Petitioner's gross income at the end of each year was as follows: He subtracted the amount in the bank at the beginning of the year from the amount in the bank at the end of the year. He then added to the net increase or decrease in the bank balance all of the expenses of the business and all of the withdrawals made by or for the

Petitioner. The result was considered Petitioner's gross income from the Kingston Club.

"The accountants disregarded cash receipts (other than those deposited and reflected in the bank balance) and also disregarded cash pay outs except those pay outs substantiated by a memorandum from Petitioner. This was done on the theory that the $3,000 revolving fund remained approximately the same throughout the period.

"From the gross income thus arrived at Murton would deduct the Petitioner's deductible expenses.

"[Petitioner did not inform Murton that he received a substantial amount of checks in each of the years in question in connection with his business as betting commissioner which he endorsed but did not deposit.]

"For about five months in 1950, while Murton was ill, Evje acted in his place and followed the same methods. Evje never saw any books recording cash receipts or betting records relating to Petitioner's activities as betting commissioner. Murton died some time in 1951.

"All business expenses listed on Murton's summaries and claimed as deductions on Petitioner's returns were allowed by Respondent.

"Annual summary sheets were prepared by Murton and furnished to Petitioner and mailed to Calegari, a certified public accountant who prepared Petitioner's income tax returns. The summary sheets for the three years here involved were furnished by Murton to

Calegari and were used by the latter in the preparation of said income tax returns. Calegari did not keep any books or records for the Kingston Club operations or for any of Petitioner's betting commissioner activities. The only records maintained by Calegari relating to Petitioner's financial affairs was a set of books for Lesly's investment in various stocks and bonds, which he held as a joint venturer or partner with his brother Herbert.

"In the preparation of Petitioner's income tax returns for the years in question, Calegari was not given access to any books or records that may have been maintained with respect to the Kingston Club or for any of Petitioner's betting activities. In preparing Petitioner's income tax returns, Calegari relied on the annual summary sheets and profit and loss statements of the Kingston Club operations, which were sent to him by Murton.

"About the end of 1950, Petitioner's Federal income tax returns for the years 1948 and 1949 were audited by Internal Revenue Agent Parenti. The bank statements, cancelled checks and memoranda of cash expenditures referred to above, used in the preparation of the summary sheets for 1948 and 1949 by Murton, had been kept by the latter either at his home or in his office, and were made available to Parenti.

"Parenti based his examination of Petitioner's returns for 1948 and 1949 entirely on information and data furnished by Evje of Murton's office. After Parenti audited Petitioner's returns for the years

1948 and 1949, he prepared and filed a report indicating deficiencies as follows: 1948—$5,505.67; 1949—$4,689.23.

"At the time of the trial in the instant case, the bank statements and cancelled checks for the years 1948 and 1949 could not be found. Petitioner was able to produce only his cancelled checks for the last 11 months of 1950 and bank statements for the year 1950.

"In 1952, Internal Revenue Agent Glenn Adrian conducted an original examination of Petitioner's return for 1950 and a re-examination of his 1948 and 1949 returns. At this time there was a nation-wide investigation of betting commissioners and others engaged in gambling activities. As a result of this drive, Adrian had acquired, at the time of his investigation, photostats of checks paid to or endorsed by 'Les Cohen,' which had been received from other revenue agents' offices throughout the United States. Many of said checks had been endorsed and cashed by Petitioner and had not been deposited in his commercial bank account. This information had not been available at the time of Parenti's examination.

"Adrian obtained authorization from the Commissioner of Internal Revenue for a re-examination of Petitioner's returns for 1948 and 1949, and a copy of said letter was furnished to Petitioner. At the beginning of his examination, Adrian contacted Calegari and was advised by him that Petitioner's attorney had all of Petitioner's existing books and records. Later, an agent of the Intelligence Division of the

Internal Revenue Service communicated with Petitioner's attorney and was informed that the attorney had all of Cohen's books in his office. In May 1952, Adrian caused a registered letter to be sent to Petitioner requesting that he produce his records, and a follow-up letter was sent to Petitioner in September of 1952. Petitioner neither answered the letters nor produced his books and records. Thereafter, Adrian contacted Petitioner's attorney who informed the agent that he would look at the records in his possession and would let Adrian know whether he could see them. Later the attorney informed Adrian that he had looked at the records and that he would not show Adrian anything.

"Adrian proceeded to make his audit on the basis of third-party records to the extent that they were available. The available records were (1) bank deposit tags which showed dates and amounts of deposits and a number identifying the banks on which the deposited checks were drawn, but no names identifying the makers of the checks; (2) copies of bank statements of Petitioner's accounts showing total deposits, and amounts and dates of payment of checks drawn on the account, but without names or other identification of payees; (3) photostatic copies of checks payable to Les Cohen obtained from other internal revenue agents' offices, and (4) a transcript of an account on the books of the Film Row Club showing Petitioner's wins and losses from [personal] bets at that club.

"Petitioner's wins and losses from gambling at the Film Row Club were as follows:

Year	Amount Won	Amount Lost
1948	$61,695.00	$79,075.00
1949	63,500.00	69,912.50

"Respondent computed Petitioner's taxable income for the years in question by the so-called bank deposit method. He determined that all monies deposited in the commercial bank and all checks received and endorsed but not so deposited (to the extent he had knowledge of them at the time the statutory notice was mailed) and all wins from the Film Row Club constituted income. [Because of lack of substantiation, no deductions were allowed for pay outs or losses.] None of the deductions claimed on Petitioner's returns were disallowed.

"Revenue Agent Adrian did not attempt to compute Petitioner's net income by the so-called net worth method because Petitioner dealt in large sums of cash and the agent did not feel that he could accurately determine net worth for that reason and also because, having been refused Petitioner's books, he would not know how Petitioner made his investments.

"In Petitioner's tax returns for 1948 through 1950, inclusive, on Schedule C, page 2 (profit or loss from business), the nature of the business was stated to be 'brokerage.'

"Gross profits (listed as total receipts) from the Kingston Club operations are reported on Petitioner's tax returns for the years 1948 and 1949 in the amounts of $56,795.13 and $66,274.91, respectively. On Petitioner's original income tax return for the year 1950,

he reported gross profit (listed as total receipts) from Kingston Club in the amount of $1,836.28, and a net loss of $26,687.91. On July 28, 1954, Petitioner filed an amended return for the year 1950 on which he reported gross income (listed as total receipts) from Kingston Club of $8,207.71 and a net loss of $15,125.75.

"During the years involved herein, Lesly had a safe deposit box at the Bank of America, Day and Night Branch.

"During each of the taxable years in question, Petitioner received substantial commissions in cash from local customers. His settlements with local betting were almost entirely in cash, and reflected his share of commissions.

"Petitioner's gross income from his activities as betting commissioner and the operation of the Kingston Club card room for the respective years in question did not exceed the following: 1948—$167,000; 1949—$145,000; 1950—$108,000.

"[Petitioner, in his income tax returns for each of the years in question, substantially understated income from his activities as betting commissioner and the operation of the Kingston Club card room.

"A part of the deficiency for each of the years involved was due to fraud on the part of Petitioner with intent to evade taxes within the meaning of Section 293(b).]"

PETITIONER'S OBJECTIONS TO FINDINGS.

Petitioner objects to the Court's reference to personal gambling activity as unsupported by the record. Petitioner's position is that the transactions with the Film Row Club were exactly the same as the transactions that Petitioner had with the various other betting establishments whose names appear in the Stipulation of Facts.

Petitioner objects to the statement that Petitioner did not inform Murton that he received a substantial number of checks in each of the years in question in connection with his business as betting commissioner, which he endorsed but did not deposit. The evidence taken as a whole shows that Murton was completely conversant with Petitioner's method of operation.

We object to the finding that the Respondent disregarded pay outs or losses for lack of substantiation. Petitioner contends that the Respondent's action was politically inspired and was part of the national upheaval in 1952, and that the purpose of the Respondent's fantastic determination and the publicity attending the levying of the Jeopardy Assessment were designed to divert public attention from the current attacks on the Bureau of Internal Revenue

And finally, Petitioner completely disagrees with the last two paragraphs of the Court's findings. There is absolutely no evidence that the Kingston Club card room did not correctly report its income and the Respondent has never contended otherwise. There is no evidence to support the finding that Petitioner sub-

stantially understated his income from his activities as a betting commissioner and the Court's findings in that regard are wholly dependent upon an alleged presumption in favor of the validity of the Respondent's determination. Petitioner contends that the finding of fraud is contrary to the evidence. Petitioner strongly contends that the Court's finding that Petitioner understated his income as a betting commissioner is against a clear preponderance of the evidence. The available records strongly support the reliability of Petitioner's income tax returns. The audit made by the Internal Revenue Agent Parenti, through years 1948 and 1949, strongly supports Petitioner's contention that his returns for those years were accurate. Petitioner placed in evidence his net worth statement, which is consistent with his reported income. Petitioner's manner of living, personal expenses and non-deductible expenditures were all consistent with his income as disclosed by his income tax returns. Petitioner's own testimony was strong and clear and in the absence of contradictory testimony the Tax Court was not at liberty to disregard it.

The questions presented on this appeal are:

First: Did the Tax Court err in holding that Petitioner failed to show that the Respondent's determination of deficiency was arbitrary and invalid, and that the burden of proof was on Petitioner to prove that he did not owe the amounts determined by the Commissioner?

Second: Are there material errors in the Tax Court's findings of fact, and

Third: Did the Tax Court err in holding that Respondent affirmatively proved that a part of the deficiency in each year was due to fraud with intent to evade tax.

SPECIFICATIONS OF ERROR.

I. The Tax Court erred in holding that Petitioner failed to show that the Respondent's determination of deficiencies was arbitrary and invalid and that the burden of proof was on Petitioner to prove that he did not owe the amounts "determined" in the deficiency notice.

II. The Tax Court's findings of fact are erroneous in several material matters:

(1) The statement that Petitioner engaged in *personal* gambling at, or with, the Film Row Club finds no support in the record.

(2) The finding that Respondent's treatment of the Film Row Club wins and losses was not arbitrary or unreasonable is contrary to law.

(3) The various findings that state or imply that Petitioner withheld essential information from his accountant are unsupported by the record.

(4) The finding that Petitioner substantially understated income from the Kingston Club Card Room is contrary to the record and raises an issue which the Respondent has conceded.

(5) The finding that the Petitioner in his income tax returns for the years in question substantially understated the income from his activities as betting

commissioner is a general conclusion and is not specific or definitive enough to enable the court of review to pass upon its validity (221).

(6) The finding that Petitioner failed to establish that his income from his activities as betting commissioner and his operation of the Kingston Club Card Room was not less than $167,000.00 in 1948; $145,000.00 in 1949; and $108,000.00 in 1950 is a mere conclusion unsupported by specific and definitive findings of fact (221).

(7) The finding that Petitioner received commissions in cash from local bettors in amounts not less than $69,000.00 in 1948; $60,000.00 in 1949; and $44,000.00 in 1950, is a general conclusion, not supported by specific, definitive findings of fact (241).

(8) The finding that cash received from local bettors was retained by Petitioner and therefore not reported as income under Murton's method of reporting income is contrary to the evidence.

III. The Tax Court erred in holding that Respondent has affirmatively proved that a part of the deficiency in each year was due to fraud with intent to evade tax.

SUMMARY OF ARGUMENT.

I. The Tax Court erred in holding that Petitioner failed to show that the Respondent's determination of deficiency was arbitrary and invalid, and that the burden of proof was on Petitioner to prove that he did not know the amount determined by Commissioner.

Petitioner contends that the record shows that the Respondent's determination was arbitrary and excessive and consequently that the presumption in favor of Respondent's determination disappeared. The judgment of the Tax Court is wholly dependent upon the existence of the presumption. The Court did not find unreported income in any specific amount; it merely found that it is not likely that Petitioner received gross commissions in excess of specific sums and "that Petitioner has failed to establish a lesser amount."

The Tax Court holding that Respondent's determination is not arbitrary and invalid is contrary to the record and to the Court's own findings of fact and is contrary to law.

1. The size of the deficiencies, the wording of the deficiency notice and the manner that the assessment was levied, all show that the Respondent intentionally determined an arbitrary and excessive assessment as a part of the national crackdown on illegal gambling in 1952.

2. Information available to Respondent as a result of the Parenti audit showed that the determination was intentionally, or recklessly, arbitrary and excessive.

3. Respondent knew that Petitioner was a betting commissioner and that his gross income would be but a small percentage of his gross receipts.

4. Respondent knew that bank deposits and checks cashed or endorsed would have no reason-

able relationship to Petitioner's income from commissions.

5. Respondent's action in including wins and disregarding losses from the Film Row Club shows that his policy was to "determine" the highest possible amount and attempt to throw upon the Petitioner the burden of proving that the determination was wrong.

The Petitioner relies upon the well-established rule that the taxpayer meets the burden of proving the Commissioner's determination invalid when he shows that the determination was arbitrary and excessive. The taxpayer is not required to prove, in addition, that he owes no tax, nor is he required to prove the correct amount of the tax that he owes.

II. The Tax Court's findings of fact are erroneous in several respects:

1. The finding that Appellant engaged in personal gambling at the Film Row Club is contrary to the evidence. Petitioner's transactions with the Film Row Club were on exactly the same basis as his transactions with Corbett's or Harold's Club, or any of the other betting establishments mentioned in the evidence. A correct finding in this particular would tend to show that the Commissioner's determination was arbitrary and invalid.

2. The finding that Respondent's treatment of the Film Row Club losses was not arbitrary or unreasonable is contrary to law.

3. Several findings state, or imply, that Petitioner withheld essential information from his accountants. The undisputed testimony in the record shows that Petitioner's accounting system was set up by the accountant, Murton, and that Murton devised this system of accounting to enable Petitioner to correctly report his income without the necessity for maintaining records of individual transactions.

4. The finding that Petitioner substantially understated income from the Kingston Club card room is contrary to the record and raises an issue, which the Respondent did not raise.

5. The finding that Petitioner substantially understated income from his activities as betting commissioner is a conclusion which is stated by the Court to be based upon the consideration of various enumerated factors; however, the Court has made no specific, definitive findings which show how much weight, or valuation was placed upon the various factors, so that it is impossible for the court of review to tell from the findings whether the Tax Court's conclusion was valid, or not.

6. The finding that Petitioner failed to establish that his income from his activities as betting commissioner, and the operation of the Kingston Club card room, was not less than $167,000 in 1948; $145,000 in 1949; and $108,000 in 1950, is contrary to law and is not supported by the record. Again, the finding is a conclusion from a summary of other facts in evidence, but the Tax Court failed to make any specific and

definitive findings by which this Court could check the validity of its conclusion.

7. The finding that Petitioner received commissions in cash from local bettors in amounts not less than $69,000 in 1948; $60,000 in 1949; and $44,000 in 1950, is contrary to the evidence. The finding is a mere conclusion based upon vague computations and assumptions and which do not contain sufficient information to enable the reviewing Court to pass upon the validity of the finding.

8. The finding that cash received from local bettors was retained by Petitioner in cash and not reported as income under Murton's method of reporting income is contrary to the evidence. It is self-evident that if the cash revolving fund did not exceed $3,000 at the end of any tax year, Murton's method of accounting would correctly reflect all of Petitioner's income. There is no evidence in the record from which it could reasonably be inferred that Petitioner retained cash in excess of the $3,000, which is admitted.

III. The Tax Court erred in holding that Respondent has affirmatively proved that a part of the deficiency in each year was due to fraud with intent to evade tax. The Tax Court correctly states the applicable rules of law, i.e., "the burden of proof with respect to fraud is upon the Respondent, and he must establish fraud on the part of Petitioner by clear and convincing evidence". "We recognize that Respondent cannot meet his own burden of establishing fraud on the basis of Petitioner's failure to discharge the

burden of proving error in the determination of deficiencies, and we do not, of course, rest our finding of fraud on that basis. The existence of fraud with intent to evade tax must be affirmatively established by Respondent." The basis of the Court's conclusion that there was a substantial understatement of income on Petitioner's return for each of the taxable years in question is stated by the Court as follows, "Taking into consideration the minimum volume of lay off bets indicated by the deposit of checks and money orders from out-of-town betting commissioners; undeposited checks and money orders from the same sources; checks of Petitioners to betting ocmmissioners; the fact that the remittances to and from Petitioner usually represented the settlement of accounts, rather than individual bets; the added fact that the Petitioner's local cash business was a substantial part of his betting commissioner activities, recognizing the percentages he received (and making allowance for splitting of commissions on out-of-town business, occasional foregoing of commissions, occasional losses, and the fact that Petitioner received commissions on horse race bets only from the loser . . .)". The Court refers to its consideration of the above-named factors as an "analysis of the record". If it is really an analysis, and not merely "an educated guess", the details of the computation should be set forth in specific and definitive findings of fact. For the purpose of making a "half arbitrary, half intelligent" guess under the *Cohan* rule, the Tax Court is permitted to make general estimates. In determining the existence

of fraud with intent to evade tax, all of the facts necessary to establish the fraud must be clear and convincing. The Petitioner and the court of review are entitled to know what the Tax Court established as the total volume of business transacted by Petitioner; what rate of percentage was applied; and what allowance was made for splitting commissions; what allowance was made for foregoing commissions; and what allowance was made for occasional losses; and what allowance was made for the fact that Petitioner received commissions on horse race bets only from the loser.

The Court may not reject the Petitioner's testimony to the effect that his returns were honest, correct and complete where there are no facts in the record to contradict such testimony. The truth of Petitioner's testimony is corroborated by available records, the audit of Internal Revenue Agent Parenti for two of the three years in question, the checks and bank statements available for the year 1950, Petitioner's net worth, manner of living and personal expenses.

ARGUMENT.

I. THE TAX COURT ERRED IN HOLDING THAT PETITIONER FAILED TO SHOW THAT THE RESPONDENT'S DETERMINATION OF DEFICIENCIES WAS ARBITRARY AND INVALID AND THAT THE BURDEN OF PROOF WAS ON PETITIONER TO PROVE THAT HE DID NOT OWE THE AMOUNTS "DETERMINED" IN THE DEFICIENCY NOTICE.

The Petitioner relies upon the well-established rule that the Taxpayer meets the burden of proving the Commissioner's determination invalid when he shows

that the determination was arbitrary and excessive. The taxpayer is not required to prove in addition that he owes no tax, nor is he required to prove the correct amount of the tax that he owes. The Respondent long contended that the burden is on the taxpayer not only to prove that the Commissioner's determination is erroneous, but to show the correct amount of the tax. This argument was finally laid to rest by the Supreme Court in *Helvering v. Taylor,* 293 U.S. 507, 55 S. Ct. 287, 79 L. ed. 623:

> "We find nothing in the statutes, the rules of the board, or our decisions, that gives any support to the idea that the Commissioner's determination, shown to be without rational foundation and excessive, will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the correct amount. While decisions of the lower courts may not be harmonious, our attention has not been called to any that persuasively supports the rule for which the Commissioner here contends.
>
> Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid (citations omitted). Frequently, if not quite generally, evidence adequate to overthrow the Commissioner's finding is also sufficient to show the correct amount, if any, that is due. . . . But, where as in this case, the taxpayer's evidence shows the Commissioner's determination to be arbitrary and excessive, it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe, unless his evidence was sufficient also to establish the correct amount that lawfully might be charged against him."

The rule above quoted has been followed in many subsequent cases including the following:

Federal National Bank of Shawnee v. Commissioner, 180 Fed. 2d 494, 39 AFTR 25.

A. & A. Tool & Supply Co. v. Commissioner, 182 Fed. 2d 300, 39 AFTR 517.

Gasper v. Commissioner, 225 Fed. 2d 284, 47 AFTR 1848.

H. T. Rainwater, 23 TC 450.

The Respondent's Deficiency Notice, dated November 25, 1952, with attached statement, is set forth at pages 7-12 of the Transcript. The letter states that the assessment of such deficiency, or deficiencies, has been made under the provisions of the Internal Revenue laws applicable to jeopardy assessments. There follows a statement of the alleged deficiency and penalty for each of the three years, followed by the explanation, "The determination of your tax liability and penalty is made on the basis of information on file in this office." (9). There are two additions to income for the year 1948: (a) interest, $159.12, which is not at issue here; (b) business income, $693,189.62, and the only explanation of this adjustment is as follows, "(b) available information discloses that income in the amount of $693,189.62 was not included in the net income as reported." (9). For the year 1949, the only item in this statement is, "(a) business income, $542,-478.73", and under explanation of adjustments, "(a) available information discloses that income in the amount of $542,478.73 was not included in the net income as reported." (10). For the year 1950, the state-

ment includes the following, "(a) business income, $326,095.00", explanation of adjustments, "(a) available information discloses that income in the amount of $326,095.00 was not included in income as reported." (11).

The foregoing represents the entire determination of the Commissioner concerning unreported income, as the rest of the statement is a mere computation of taxes and penalties. The addition of the small interest item and three items of alleged business income are the only changes proposed by the Commissioner for the years in question. He does not question the deductions claimed on Petitioner's income tax returns.

On the basis of information on file in his office (but not included in the Deficiency Notice or statement) the Respondent filed a Jeopardy Assessment on the assets of the taxpayer in the fantastic sum of $1,193,511.18, plus a penalty of $596,755.59. Respondent never disclosed to Petitioner, or his counsel, what the "information" referred to in the statement was, until almost the close of the hearing before the Tax Court, when Internal Revenue Agent Glenn H. Adrian was on the stand (189-205). Respondent rested his case as soon as Mr. Adrian had testified (205).

Mr. Adrian was the Internal Revenue Agent who prepared the report which was the basis for the Commissioner's Jeopardy Assessment and determination of deficiencies (197). Mr. Adrian testified that the sums designated in the deficiency letter as additional business income were made up from three sources: (1) the Petitioner's total bank deposits, including

cash and checks; (2) the sum of a considerable number of checks which had been cashed, or endorsed, by the Petitioner and not deposited in the bank; (3) the *wins* from the Film Row Club (194, 197).

The Tax Court concedes that the wins from the Film Row Club did not constitute income (225). The net effect of the Court's other findings is that the bank deposits did not include any *unreported* income (241-242). By resolving every possible inference against the Petitioner, not more than $140,722.25 of the checks "received and endorsed" but not deposited, could represent unreported income. The Court found that Petitioner's cash commissions from local bets totalled $173,000, of which approximately $25,000 was deposited in the bank, leaving $148,000, which Petitioner is deemed to have received and retained in cash from local transactions (241). The Court found that the total unreported commissions for the three years could not have exceeded $288,721.25. If we deduct the $148,000 alleged to have been received in cash from local bettors, the greatest amount that could have been received and retained from the checks cashed would be $140,722.25 (242). Of course, the Court did not find any specific amount of unreported income. It merely said that it was satisfied that the taxpayer could not have had more unreported income than the maximum stated. The amount of income reported by the Commissioner, the maximum possible unreported commissions found by the Tax Court, and the amounts claimed by the Commissioner in his Deficiency Letter, are set forth as follows:

	Petitioner Reported	Tax Court Maximum	Commissioner Claimed
1948	$ 56,795.13	$110,204.87	$ 693,189.62
1949	66,274.91	78,725.09	542,478.73
1950	8,207.71	99,792.29	326,095.00
	$131,277.75	$288,722.25	$1,561,763.35

In spite of the fact that none of the Film Row wins, none of the bank deposits, and not more than $148,000 of the undeposited checks, could have constituted unreported income under the Tax Court's own findings, it nevertheless refused to find that the Commissioner's determination was arbitrary and excessive. It is the Petitioner's contention that the undisputed facts, as disclosed by the record in this case, show that, as a matter of law, Respondent's determination was arbitrary and excessive and that the Court below erred in holding that the burden was upon Petitioner to establish that he did not owe any deficiencies in income taxes for the years in question.

The Tax Court leans heavily upon the case of *Doll v. Glenn,* (6 Cir.) 231 Fed. 2d 186, 49 AFTR 412, and the cases cited therein, to support its holdings. Its argument is, that in the absence of books and records, the Commissioner is justified in making his determination on the basis of the bank deposit method (222), however, none of the cases cited holds that the absence of records will justify the Commissioner in using the bank deposit method in an arbitrary or unreasonable manner.

This is made perfectly clear by the Sixth Circuit, which decided the *Doll* case, in the case of *Schira v. Commissioner,* 240 Fed. 2d 672, 50 AFTR 1404, wherein the Court said,

> "Petitioners also contend that there was not sufficient evidence to sustain the assessments, which, because of the absence of books and records, were merely unwarranted estimates on the part of the Commissioner. In the absence of books and records, the Commissioner was justified in making assessments based upon other available evidence, provided they were not arbitrary or unreasonable. Doll v. Glenn, 231 F. 2d 186, 188. In the opinion of the Court, the assessments, although necessarily largely in the nature of estimates, were not arbitrary or unreasonable. Being presumptively correct, the burden rests upon the taxpayer to prove them erroneous."

The undisputed facts in this case show that the Commissioner's determination was arbitrary and excessive.

(1) The Fantastic and Unrealistic Amounts Claimed in the Deficiency Notice, the Arrogant Failure to State the Basis of the Determination in the Notice, the Deliberate Levy of a Jeopardy Assessment for $1,790,266.77, All Show That the Respondent Intentionally Determined an Arbitrary and Excessive Assessment as Part of the Nationwide Crackdown on Illegal Gambling in 1952.

The special Senate investigating committee, commonly called the Kefauver Committee, had focused the attention of the country upon the activities of betting commissioners, as well as bookmakers, numbers operators, and other types of illegal gambling. The In-

ternal Revenue service itself was under heavy attack and many of its high officials were subsequently indicted and convicted. 1952 was a presidential election year and the party out of power seized upon corruption in the Bureau of Internal Revenue as an election issue. Whatever its motives may have been, the historical fact is that the Bureau of Internal Revenue set up a special "racket squad" and commenced a nation-wide crackdown on gambling. See the testimony of Robert K. Lund, Assistant Chief, Intelligence Division, Internal Revenue Service in San Francisco (173-176). It will be noted that Mr. Lund attempted to get possession of the Petitioner's books, not in connection with any investigation of Petitioner, but in connection with investigations of other taxpayers. The information collected in the Stipulation on file in this case was gathered by income tax investigators all over the United States. The very size of the proposed deficiencies indicates a reckless disregard of Petitioner's rights. After resolving every doubt against the Petitioner under the *Cohan* rule, the Tax Court found that the highest possible amount of unreported income was less than one-fifth the amount set forth in the Deficiency Notice. Normally, the Commissioner sets forth in his Deficiency Notice at least a summary of the facts upon which he relies. The very least that he should have done in this case would have been to indicate that he was using the bank deposit method. It seems obvious that Adrian knew that he had no rational basis for the determination and by simply referring in the Deficiency Notice to "available informa-

tion'' he left the door open for the use of any information that might be acquired at any time up to the time of trial. The levying of a Jeopardy Assessment, where no jeopardy was shown to exist, indicates that the Bureau of Internal Revenue was intent upon getting all of the publicity possible out of its nation-wide crackdown.

(2) Information Available to Respondent as a Result of the Parenti Audit Shows That the Determination Was Intentionally, or Recklessly, Arbitrary and Excessive.

The Tax Court completely failed to understand the importance of the Parenti Audit and Report, in connection with the issue of whether or not the determination of the Commissioner was arbitrary. The Court merely held that the fact that a prior examination made by Revenue Agent Parenti did not develop any substantial omissions of income was of no significance (243). The Tax Court correctly points out, ''Parenti's examination and report were in no sense binding on Respondent''. On the other hand, Respondent cannot deliberately ignore the information in his own files and then claim that his determination was not arbitrary. Mr. Parenti's report is marked ''Exhibit 6'' and is worthy of careful study. It should be noted that Mr. Parenti's audit took place only a few months before that of Mr. Adrian. Mr. Parenti conducted his investigation in the manner that a normal audit would be conducted by an Internal Revenue Agent in normal times. Mr. Parenti's work sheets and audit papers must have been available to Mr. Adrian, but they were not used. The very nature of the adjust-

ments made by Mr. Parenti showed that his investigation must have been thorough. He had the bank statements and cancelled checks for 1948 and 1949, which are now lost. He had Murton's ledger and work sheets. Adjustment "(a)" for both years involved payroll taxes, showing that Parenti considered the taxpayer's deduction. Adjustment "(b)" in both years states that taxpayer understated net receipts in the amount of $5,193.84 for 1948, and $2,996.99 for 1949. Obviously, these figures ending in odd dollars and cents, came from some definite source. They indicate that Parenti attempted to audit the taxpayer's net receipts, and that he necessarily had to learn Murton's method of ascertaining income. While he did adjust some of the items, he did not indicate that as a method of accounting it was not acceptable to the Internal Revenue service. Third, Parenti's work sheets must show what items make up the alleged understatement of net receipts. It is a fair inference that if Mr. Parenti's work sheets or testimony would have been unfavorable to Petitioner he would have been called to the stand by the Respondent. Petitioner naturally assumed that Mr. Parenti would be called, since he sat in Court with the Respondent's other witnesses until the Court recessed for dinner. In "(c)" of the Parenti report, he adds $4,000.00 each year as estimated personal expenses included in business deductions. This is a round figure, candidly labeled "estimate". Since the expenses paid by check were definitely ascertainable from the checks in his hands, Mr. Parenti's estimates were necessarily concerned with

cash expenditures. Therefore, Mr. Parenti must have known of taxpayer's practice of dealing in cash. He also had an opportunity to ascertain the taxpayer's personal habits and manner of living. Yet, the year before the "heat was on", and considering the taxpayer's circumstances on the merits only, Mr. Parenti estimated personal expenditures of $4,000.00 per year. We can assume that this estimate represents his fair and considered judgment, uninfluenced by political necessities or a "national upheaval".

Mr. Parenti's audit was far from perfunctory, nor were the results negligible. In 1948, taxpayer's income tax was shown on his return as $8,357.98, and Parenti assessed an additional $5,505.66; in 1949, the returns showed a tax of $14,501.28, and Parenti assessed an additional tax of $4,689.23. In order to have made these substantial adjustments, Parenti must be deemed to have made a rather thorough audit. The record shows that he received the taxpayer's fullest cooperation and nothing was withheld from him. The only information that Adrian had that Parenti did not have was the various checks picked up over the country during the nation-wide crackdown on gambling. Since Mr. Parenti must have known that Petitioner was dealing principally in cash, and was working on a commission, the discovery of the cashed checks is not significant. If Petitioner had received cash by Parcel Post the result would have been the same. The proceeds would have gone to pay the winners in San Francisco and any excess over the usual revolving fund would have been deposited in the bank. If the

Respondent had used the available information in the Parenti file, he would have known that Petitioner worked on a commission basis and that the withdrawals by check from the checking account approximated the deposits. Respondent should not be permitted to ignore the information in the Parenti papers and then say that his Jeopardy Assessment for almost $1,800,000.00 was made in good faith.

(3) Respondent Knew that the Petitioner Was a Betting Commissioner and That His Gross Income Would Be But a Small Percentage of His Gross Receipts.

Respondent also knew that the amount set forth on line 1 of Schedule C of Petitioner's income tax returns showed net receipts, not gross receipts (Parenti report, Exhibit 6). Parenti's report is hardly necessary to establish this fact, as it is obvious that the total amount set forth on Schedule C, line 1, is treated throughout the returns as gross income, and not as gross receipts. Obviously, a betting commissioner would have to handle large sums of money, in order to make gross income in commissions equal to the amount reported by petitioner on his income tax returns. There is a definite difference in the tax law between gross income and gross receipts. A taxpayer must be prepared to prove the validity of his deductions from gross income, not from gross reecipts. This is the error in Adrian's explanation that he thought he was merely setting up Petitioner's gross income as evidenced by the bank deposits and then it would be up to the Petitioner to prove his deductions. The Tax Court correctly held that Petitioner had neither wins

nor losses and that his income was derived from commissions.

(4) Respondent Knew That Bank Deposits and Checks Cashed, or Endorsed, Would Have No Rational Relationship to Petitioner's Income From Commissions.

The Tax Court used the amount of the bank deposits and checks cashed with other information to estimate the volume of business upon which Petitioner receives commissions and on that basis found that Petitioner's commissions could not exceed sums amounting to less than one-fifth of the amount the Respondent determined. We think this case is a good example of an alarming trend among revenue agents to issue a Deficiency Notice with no rational basis in fact, with the idea that the taxpayer will be compelled to prove that he does not owe the deficiency.

(5) Respondent's Action in Including Wins and Disregarding Losses From the Film Row Club Shows That His Policy Was to Determine the Highest Possible Deficency and Throw Upon the Petitioner the Burden of Proving That the Determination Was Wrong.

Adrian's handling of the Film Row Club transactions casts grave doubts upon the truth of his statement that he would have been glad to have allowed pay outs against the bank deposits, but had no information concerning any pay outs. He had just as much information about the Film Row Club losses as he had about the gains. The schedule upon which he relied was secured from another revenue agent and was not in any degree binding upon this Petitioner. Adrian was compelled to admit that he had just as much reason to believe that the statement

of losses was correct as he had to believe that the statement of wins was correct.

The Tax Court was under a complete misapprehension concerning Petitioner's transactions with the Film Row Club. It refers to Petitioner's *personal* gambling. Petitioner testified that he never intentionally gambled and the Court so found. We are utterly at a loss to see how the idea of personal gambling got into the Court's findings of fact. The Film Row Club was no different than Harold's Club, Corbett's, or any of the other betting establishments whose names appear in the record. The only difference is that Respondent's agent happened to get hold of a schedule of wins and losses from that particular account. While the Tax Court's reasoning was clearly erroneous, its refusal to allow the excess of loss over wins was correct. Incidentally, Petitioner never contended before the Tax Court that the excess of losses should have been allowed as a deduction. We took the position there, as we do here, that both wins and losses are immaterial. We have no doubt that if similar schedules were available for all of Petitioner's accounts, the aggregate wins and losses would balance. The Tax Court opinion recognizes this fact in connection with all transactions, except the Film Row Club and there is nothing in the record to justify giving different treatment to the Film Row Club transactions. Neither the wins nor the losses in any of Petitioner's transactions were relevant except to the extent that they might indicate the volume of business upon which Petitioner received commissions (151).

The net result of the Tax Court's holding in connection with the Commissioner's presumption is, that no matter how fantastic and completely unreasonable the Commissioner's determination of deficiencies is, in the absence of books and records the Commissioner's determination is not arbitrary. The authorities on which the Tax Court relies do not support that contention. *Schira v. Commissioner,* supra. We respectfully submit that a consideration of the entire record shows that the Commissioner's determination was arbitrary and excessive and therefore, that the Court's ruling that the burden of proof was on Petitioner to show that he did not owe the deficiencies assessed against him, was incorrect.

In the recent case of the *Estate of Albert E. MacCrowe, et al., v. Commissioner,* 1 AFTR 2d 58-886, 252 F. 2d 293, the Fourth Circuit remanded the case to the Tax Court because there were no findings upon which the Tax Court's determination could be based. The Commissioner had arrived at deficiencies in the reported income of a deceased physician for the years of 1948 and 1949 by estimating the number of patients operated on by the physician on the basis of morphine tablets purchased by him and multiplying this by a charge of $400.00 per patient. This resulted in a total of $192,000.00 for 1948 and $96,000.00 for 1949. The Tax Court found these determinations to be incorrect, but that the physician's gross income from medical practice was $115,000.00 for 1948 and $55,000.00 for 1949, without, however, finding the facts upon which this determination was based. In re-

manding the case to the Tax Court for additional findings, the Court said:

> "We find, however, the same defect in the determination of gross income from medical practice as when the case was originally before us. The income as determined by the Commissioner on the basis of morphine tablets purchased and $400 charge per patient is still $192,000 for 1948 and $96,000 for 1949; neither of these amounts is accepted by the Tax Court; any presumption as to the correctness of the Commissioner's determination is accordingly out of the case; and the Tax Court has made no findings whatever upon which its determination of gross income of $115,000 and $55,000 from medical practice can be supported, nor does it give any reason for the figures at which it arrives."

We respectfully submit that a consideration of the entire record shows that the Commissioner's determination was arbitrary and excessive and therefore, that the Court's ruling that the burden of proof was on Petitioner to show that he did not owe the deficiencies assessed against him, was incorrect.

II. THE TAX COURT'S FINDINGS OF FACT ARE ERRONEOUS IN SEVERAL MATERIAL MATTERS.

In Part I of this Argument, Petitioner has discussed his objections to the Tax Court's findings that Respondent's original determination was not arbitrary and excessive. In Section III we will discuss those findings involved in the fraud issue. This section deals principally with errors and omissions in

the Tax Court's findings in connection with deficiencies in income taxes. Even though the Tax Court reduced Respondent's claim to less than one-fifth of the deficiencies claimed, the amount of tax determined by the Tax Court to be owing by this Petitioner still greatly exceeds Petitioner's entire gross income for the three years in question. Petitioner respectfully contends that this case should be remanded to the Tax Court because of the following errors and omissions:

(1) The Statement That Petitioner Engaged in Personal Gambling At, or With, the Film Row Club Finds No Support in the Record.

We refer to the statements of the Court set forth on page 209, "In his personal gambling activity at the Film Row Club, his losses exceed his gains", and on page 219, "and (4) a transcript of an account on the books of the Film Row Club showing Petitioner's wins and losses from personal bets at that club." The only evidence in the record in connection with the Film Row Club is found in the testimony of Internal Revenue Agent Glenn H. Adrian. The only part of that testimony which is relevant to this finding is as follows (194-195):

> "Q. (by Mr. Nyquist): You mentioned the Film Row Club. Will you tell us what information you had about the Film Row Club?
>
> A. There was an examination made by our office of the Film Row Club, and during the examination there was given to the agent the records, and in the records were bets with Mr. Lesly Cohen, and the agent gave to me a tran-

> script of the wins and losses, and I used that transcript, as I say. I took the wins and put them in my schedule as gross income, or as income."

It is respectfully submitted that there is nothing in the record from which a reasonable inference could be drawn that Petitioner's business with the Film Row Club was any different than it was with the other betting establishments with whom he did business. For example, the Horseshoe, Nationwide Sport Service, Baseball Headquarters, and the other firms whose names appear in the Stipulation of Facts. The Petitioner testified that he did not intentionally gamble (160) and the Court correctly found:

> "Occasionally, through miscalculations, on Petitioner's part, or other unforseeen circumstances, he accepted a bet and could not arrange to lay it off. He then found it necessary to carry the other part of the bet. On these occasions, he acted as a bookmaker to the extent that he himself carried the bet. Except for such occasional instances he did not carry any part of the bet himself." (210-11).

(2) The Finding That Respondent's Treatment of the Film Row Club Wins and Losses Was Not Arbitrary or Unreasonable Is Contrary to Law (224).

The Tax Court accepted Adrian's explanation (195) that losses from the Film Row Club were disallowed because they were unsubstantiated and also because the year of payment was not shown (224). The Tax Court said that while Adrian's conclusions were erroneous, they were "tenable". Adrian's explanation

would have some color of plausibility if it were true that Petitioner's Film Row Club bets were personal. Once the unwarranted assumption that the Petitioner's Film Row betting was personal is eliminated, Adrian's explanation makes no sense at all. What facts were available to Adrian when he decided to call the wins income and disregard the losses? The Tax Court found that he had acquired photostats of the checks paid to, or endorsed by, Les Cohen from other Revenue Agents throughout the United States (218). He knew that Petitioner was a betting commissioner, doing an extensive local and out-of-town business and he knew that Petitioner dealt in large sums of cash (196). He knew that Petitioner had reported a large amount of gross income on his income tax returns for the years under investigation. He had access to the Parenti report, Exhibit 6. The schedule which he had received third-hand was not placed in evidence, but Adrian admitted that there was just as much reason to believe the loss figures as the win figures (199). In the light of the information available to him, Adrian knew, or should have known, that neither the wins nor the losses would have affected Petitioner's gross income from commissions. If Adrian had desired to deal fairly with the taxpayer, he would have found that Petitioner had gross income from the Film Row Club transactions equal to five percent of both wins and losses and thrown upon Petitioner the burden of showing which bets were horse race bets, in which only the loser paid the commission.

(3) The Various Findings That State or Imply That Petitioner Withheld Essential Information From His Accountant Are Unsupported by the Record.

The substance of the Tax Court's findings is that Petitioner did not inform Murton that he was dealing largely in cash, or that he received a substantial amount of checks in each year which he endorsed but did not deposit in the bank (243, 216). This finding is contrary to the evidence before the Court. The evidence shows, and the Tax Court found, that Petitioner maintained a $3,000.00 cash revolving fund and that Murton's accounting method assumed that this figure was constant (212). Murton knew, of course, that a betting commissioner dealt largely in cash. The evidence shows that he was in Petitioner's place of business at least once a month where he had an opportunity to observe the manner in which the transactions took place (214). The checks which Petitioner cashed, or endorsed, had no more significance from the standpoint of income than any other cash. It is perfectly correct to state that Petitioner never told Murton how much cash he handled, or how many checks he cashed. The understanding between them was that cash in excess of the revolving fund was deposited in the bank. This method of accounting for income had been devised by Murton and installed by him when the business was owned by Petitioner's predecessor for the very purpose of obviating the necessity of maintaining a detailed record of the cash transactions. The basic principle of Murton's method of accounting was based upon the revolving fund approximating $3,000.00 at the end of

each year. If this were true, Murton's method of arriving at Petitioner's gross income, as found by the Tax Court, would necessarily result in Petitioner's income being fully accounted for. The essence of the Tax Court's finding is that Petitioner drew off and retained cash receipts in excess of the $3,000.00 revolving fund instead of depositing that excess in the bank, in accordance with his understanding with Murton. This conclusion is stated to be based upon an "analysis" of the record (246). Unfortunately, the "painstaking analysis of all of the evidence in this case" upon which the Court based its findings is not included in the opinion (244). The Court summarizes the various factors which the analysis took into consideration, but gives no specific figures derived from the individual factors. The Tax Court's finding upon reported income is based upon the volume of business inferable from the record, (241) but we are not told what that volume is.

(4) The Finding That Petitioner Substantially Understated Income from the Kingston Club Card Room Is Contrary to the Record and Raises an Issue Which the Respondent Has Conceded.

We are amazed at the Court's finding that the Petitioner substantially understated his income from the operation of the Kingston Club Card Room (221). The Court said (237), "No separate income, or loss, from the card room operation has been reliably established." The record shows that Petitioner kept full and accurate records of all income and disbursements in connection with the card room and Respondent has never questioned them in any respect whatso-

ever. The original books of entry, kept by Mr. Elbert Wright, an employee of Petitioners, are referred to in the record as the "gray books". In his opening statement, Counsel for Respondent called the attention of the Court and Counsel to the fact that the books were in Court and available for examination (20). The Court understood that the records of the card room were not in controversy (27). Monthly summaries, taken directly from the original books of entry, are in evidence in this case (68, 70, 80, Exhibit 8). The books were in Court, available for examination by Respondent's Counsel and revenue agents who were present. The summaries that were admitted in evidence were certainly adequate to reliably establish income from the operation of the card room where Respondent did not question their accuracy in any way. From the remarks made by the Court during the trial, Petitioner had every reason to believe that the Court understood that the accuracy of the card room records was not an issue in the case (149, 183). The Court's findings are to the effect that Petitioner's unreported income from the operation of the card room and the betting commissioner business did not exceed certain specified sums. However, there is no breakdown as to how much of the alleged unreported income is attributable to the card room and how much to the betting commissioner business. Since there is not the slightest question but that Petitioner maintained full, accurate and honest accounts of all of the card room income, this case should be remanded to the Tax Court with instructions that it make proper findings concerning the

card room and eliminate from the deficiencies found any portion thereof attributable to the Court's mistaken inclusion of unreported income from the card room.

(5) The Finding That the Petitioner in His Income Tax Returns for the Years in Question Substantially Understated the Income From His Activities as Betting Commissioner Is a General Conclusion and Is Not Specific or Definitive Enough to Enable the Court of Review to Pass Upon Its Validity (221).

The Court said, "We have no doubt from the record that the understatements for each year involved are quite substantial." (230). We respectfully submit that the record before the Court did not indicate understatements for any year. The Court found that the Petitioner's source of revenue was commissions on bets placed, and that he tried to get five percent on bets, except on horse races, where only the loser paid the five percent. Therefore, his maximum would have been five percent of the sums handled. However, the Court also found that he received only a half commission and in some cases no commission when he laid off the bets with other brokers. It also found that in horse race bets he received his commission only from the loser. It thus appears that if the Petitioner laid off a horse race bet with another broker, he would receive one-half of five percent from the loser's end only. Of course, horse racing is carried on in this country at some track or other the year around, and is the back bone of all betting establishments. Other athletic events are seasonable in nature and do not have the consistent devoted following that comprises the group that bets on horse races. It would

be very unreasonable to assume that after taking into account all of the things that the Tax Court said that it took into account to find that the Petitioner averaged more than two and one-half percent on all of the transactions that he handled. On this basis, the income that he reported for the three years in question would have required a total handle of $5,251,110.00. If he had made a full five percent on every transaction that he handled (which the Court concedes he did not) the handle would have been $2,625,555.00. If his commissions averaged out half way between the maximum of five percent and the more probable two and one-half percent, the handle would have been $3,939,322.50. Therefore, in the light of the Court's other findings, it is difficult to see how the Court could arrive at the conclusion that there were substantial understatements for each year involved. The Tax Court should be required to make specific and definitive findings, showing the amount of the total handle it estimated and the basis of that estimate, otherwise this Court has no basis for testing the validity of the Tax Court's general findings.

(6) The Finding That Petitioner Failed to Establish That His Income From His Activities as Betting Commissioner and His Operation of the Kingston Club Card Room Was Not Less Than $167,000.00 in 1948; $145,000.00 in 1949; and $108,000.00 in 1950 Is a Mere Conclusion Unsupported by Specific and Definitive Findings of Fact (221).

The Court found that Petitioner's gross income from his activities as betting commissioner and the operation of the Kingston Club Card Room for the

respective years in question did not exceed the following:

1948	$167,000.00
1949	145,000.00
1950	108,000.00

The Tax Court opinion then adds, "and that Petitioner has failed to establish a lesser amount".

Of course, we do not object to the finding that Petitioner's gross income did not exceed the amounts stated. The Court could well have gone further and found that Petitioner's gross income did not exceed the amounts stated in his income tax returns. We object to the statement that Petitioner has failed to establish a lesser amount on two grounds, first, the Respondent's determination was arbitrary and excessive and did not cast upon the Petitioner the burden of going forward, second, that the Petitioner did, in fact, establish a lesser amount. We believe that the Respondent's findings should be remanded for clarification and to be made more definitive. *Showell v. Commissioner,* 238 Fed. 2d 148, 50 A.F.T.R. 674. The error in the Tax Court's finding arises from the fact that a number of factors are grouped together, and the Court states that it took them all into account. We have no way of knowing how much weight was given to each factor, and whether they were properly taken into account. The Petitioner is entitled to know, for example, the amount of the gross receipts which was *assumed* by the Tax Court for the purpose of determining the Petitioner's commission. Next, the Petitioner is entitled to know what rate of

commission was used by the Court—how much at five percent, how much at two and one-half percent, and how much at any other rate that the Court may have used. The Court must have used some type of worksheet and compiled some figures in order to arrive at the maximums set forth in its findings. Unless we know the approximate weight that the Tax Court gave to the various factors which it took into account, it is impossible for the Petitioner, or the Court of Review, to analyze the validity of the finding.

(7) The Finding That Petitioner Received Commissions in Cash From Local Bettors in Amounts Not Less Than $69,000.00 in 1948; $60,000.00 in 1949; and $44,000.00 in 1950, is a General Conclusion, Not Supported by Specific, Definitive Findings of Fact (241).

This finding is subject to the same objections that we have made to the two findings discussed in the immediately preceding sections. The general finding is based upon computations and assumptions that are not stated. The Tax Court should be required to make specific findings, which will indicate the basis of the conclusion it reached.

(8) The Finding That Cash Received From Local Bettors Was Retained by Petitioner and Therefore Not Reported as Income Under Murton's Method of Reporting Income Is Contrary to the Evidence.

The Tax Court assumes that local bets would balance out in the long run, leaving cash in Petitioner's hands which would represent his commissions, less credit losses. From this the Tax Courts draws the completely unwarranted conclusion that this residue must have been received and retained in cash because

only about $25,000.00 in cash was deposited in the bank account. Of course, if cash had been retained by Petitioner in excess of the $3,000.00 revolving fund, it would not have been reported as gross income under Murton's system of accounting. However, there is no evidence whatsoever in the record that this was done. Petitioner's testimony on this point was direct, unequivocal and uncontradicted. This testimony, that any excess cash not required by the revolving fund and not deposited in the bank account was used to pay off bets, is uncontradicted and unimpeached. Petitioner's business was one single integrated enterprise. Not only were local bettors and local betting commissioners paid off in cash, but Petitioner was required to purchase Cashier's Checks and Money Orders to supplement the checks paid to out-of-town brokers. There is much evidence in the record to corroborate Petitioner's statements that he did not retain cash in excess of the $3,000.00 revolving fund. His personal expenses and manner of living during 1948 and 1949 came under careful scrutiny in the Parenti report. His manner of living and his net worth statement are entirely consistent with his returns as filed. Respondent argues that Petitioner might have cash in his possession which would not appear in his net worth statement because its existence would be unknown to Petitioner's accountants. The same conjecture could be made concerning almost any taxpayer, whether he maintained books and records, or not. The only basis stated for the Tax Court's conclusion that Petitioner must have retained cash is the volume of local business "inferrable" from the

record. As we have pointed out in our objections to other findings, the nature and extent of the inferences drawn by the Court are not stated in any specific findings. The fact that the amount of commissions earned by Petitioner from local bettors is estimated by the Tax Court as amounts in excess of the amount of cash deposited in the bank in no way indicates that those commissions did not find their way into the bank. For example, if Petitioner had a series of transactions with an out-of-town broker in which he received checks from that broker in the sum of $10,000.00 and paid losses in a similar amount to that broker in Cashier's Checks and Money Orders, purchased with cash received from local bettors, if the checks received from the out-of-town broker were deposited in the bank the net effect would be a deposit of the commissions earned in local transactions.

III. THE TAX COURT ERRED IN HOLDING THAT RESPONDENT HAS AFFIRMATIVELY PROVED THAT A PART OF THE DEFICIENCY IN EACH YEAR WAS DUE TO FRAUD WITH INTENT TO EVADE TAX.

The Tax Court's opinion correctly states the rules of law applicable to the fraud issue, i.e., "The burden of proof with respect to fraud is upon the Respondent, and he must establish fraud on the part of Petitioner by clear and convincing evidence." (243). "We recognize that Respondent cannot meet his own burden of establishing fraud on the basis of Petitioner's failure to discharge the burden of proving error in

the determination of deficiencies, and we do not, of course, rest our finding of fraud on that basis. The existence of fraud with intent to evade tax must be affirmatively established by Respondent." (244). Petitioner contends that having stated the applicable rules the Court did not correctly apply them to the facts of this case. The Court first found that Petitioner substantially understated his income for each year. It then inferred a fraudulent intent to evade taxes from (1) consistent understatement of income, (2) failure to maintain records of cash commissions, and (3) failure to inform his accountants of these cash commissions. Finally, the Court rejected Petitioner's testimony that his returns were correct and that Murton had told him that his method of accounting was satisfactory to the Bureau of Internal Revenue. It is respectfully submitted that both the Tax Court's findings and reasoning are erroneous.

(1) The Finding That Petitioner Substantially Understated His Income for Each of the Years in Question Is Not Supported by the Record.

Since this is a crucial point in this issue involving more than $91,000.00 in penalties, we will set forth the Tax Court's findings in full (224-246):

> "After a painstaking analysis of all of the evidence in this case, and bearing in mind the above stated principles, we are convinced that petitioner received taxable income during each of the years 1948, 1949 and 1950 from his activities as betting commissioner in excess of that reported on his returns for those years, and that in each of said years a part of the deficiency was

due to fraud with intent to evade taxes. It is well settled that respondent in sustaining his burden of proof of fraud, need not prove the precise amount of the deficiency attributable to such fraud, but only that a part of the deficiency is attributable thereto. *United States v. Chapman,* 168 F. 2d 997 (C.A. 7, 1948), certiorari denied 335 U.S. 853.

Taking into consideration the minimum volume of layoff bets indicated by the deposit of checks and money orders from out-of-town betting commissioners; undeposited checks and money orders from the same sources; checks of petitioner to betting commissioner; the fact that the remittances to and from petitioner usually represented the settling of accounts rather than individual bets; the added fact that petitioner's local cash business was a substantial part of his betting commissioner activities, recognizing the percentages he received (and making allowance for splitting of commissions on out-of-town business, occasional foregoing of commissions, occasional losses, and the fact that petitioner received commissions on horse race bets only from the loser), we reach the conclusion that there was a substantial understatement of income on petitioner's return for each of the taxable years in question. We cannot, on the record before us, determine the precise amount of such understatements, and we are not required to do so. However, after resolving any doubts in this respect against respondent, with whom the burden of proof of fraud lies, we hold, upon our analysis of the record, that the understatements were substantial for each year before us. Our analysis likewise convinces us that a large part of the understatements in each of said years was attributable

> to petitioner's failure to include in his return the receipt of commissions in cash."

The case of *United States v. Chapman* cited by the Court is a criminal case having no application to the imposition of civil penalties.

The Court states that "A part of the deficiency was due to fraud with intent to evade tax", but makes no specific finding of any specific deficiency. "Judgments in Tax Court cases, as in other cases, must have a reasonable basis on facts duly found by the Court". *Estate of Albert E. MacCrowe, et al, v. Commissioner* (4th Cir.) 1 A.F.T.R. 2d 58-886.

It is very clear that without the aid of the Commissioner's presumption, which the Court admits it relied upon in connection with its finding of an understatement of taxable income for the purposes of the deficiencies involved (244), there is no specific and definite evidence of any understatement whatsoever. Under the "Cohan" rule, the Tax Court has considerable latitude.

> "When the trier of fact disbelieves, or is not satisfied, that the claimed losses were sustained, he has a right to disallow the claimed deductions. Similarly, if he thinks that the taxpayer did suffer losses much smaller than claimed, but did suffer some losses, the taxpayer cannot complain if the fact finder selects a half-arbitrary, half-intelligent figure for the losses." *Showell v. Commissioner,* 238 Fed. 2d 148, 50 A.F.T.R. 674.

In determining the existence of fraud with intent to evade tax, all of the facts necessary to establish

the *deficiency and the fraud* must be clear and convincing. There is no evidence in this case of any specific deficiency. The Court says that its conclusion that there was a substantial understatement of income is reached after a "painstaking analysis of all the evidence", but none of the evidence referred to by the Court is sufficient to affirmatively prove, by clear and convincing evidence, that any deficiency existed.

The Tax Court says that it reached its conclusion as a result of a painstaking analysis, but it neglects to make any specific findings as to what its analysis disclosed. The Petitioner and the reviewing court are entitled to know what the Tax Court established in its own mind as the total volume of business transacted by Petitioner. We have pointed out, supra, that the income tax returns filed by Petitioner showed gross commissions which would have required a volume of business in excess of five millions of dollars. Of course, the actual volume of transactions that would be required to earn gross income in the amounts reported by the Petitioner would depend upon the percentage rate collected for commissions. This, in turn, would depend upon what allowance was made for splitting commissions, what allowance was made for foregoing commissions, and what allowances were made for occasional losses, and what allowances were made for the fact that commissions were received only from the loser on horse race bets. When the Tax Court has made findings on each of these points then, and then only, will this Court be able to as-

certain whether or not its conclusion is valid. It is obvious that the Tax Court failed to make those necessary findings because there was nothing in the record which it could use as a basis for such findings. The Court said, (245) "We cannot, on the record before us, determine the precise amount of such understatement . . .". The Court might well have said, We cannot on the record before us determine *any* specific amount of understatement. We think that it is clear that the Respondent failed to establish fraud on the part of this Petitioner by clear and convincing evidence.

(2) The Tax Court Then Listed Three Things Upon Which It Based Its Finding of Fraudulent Intent to Evade Taxes.

(a) The Court inferred a fraudulent intent to evade taxes from consistent understatement of income. The validity of this reason, of course, depends entirely upon whether the evidence before the Court would justify a positive finding unaided by any presumption that there was a consistent understatement of income. As we have shown in the preceding paragraph, the Court's findings do not warrant its conclusion of consistent understated income, so consequently, there can be no inference of fraudulent intent from that conclusion.

(b) The Tax Court also infers the existence of fraud from Petitioner's failure to maintain records of his cash transactions or of the cash commissions earned in such transactions. The evidence shows, without contradiction, that Petitioner had been told that his method of accounting was satisfactory to the Bu-

reau of Internal Revenue. The fact that Petitioner had been audited by Parenti for the years 1948 and 1949, and he had not objected to the Petitioner's method of accounting, shows that Petitioner had a reasonable ground for his belief. Whether anyone in the Internal Revenue Department ever gave Murton a letter or not, is immaterial here. Murton told Petitioner that he had such a letter and Parenti's audit was certainly calculated to convince Petitioner that Murton's statement was true. As we have noted earlier in this brief, Parenti's reports show that he had to know that Petitioner dealt largely in cash, and he had to know Murton's method of reporting income. The Tax Court brushes away the argument with the totally irrelevant observation that there is nothing in evidence "to the effect that the tax authorities, or Murton, ever advised Petitioner that it was not necessary for him to disclose to Murton the full amount of his commissions, or report them in his income tax returns". The short answer to this is that there is nothing in the evidence to the effect that Petitioner did not disclose the full amount of his commissions or report them in his income tax returns.

(c) The Tax Court also infers fraud from its finding that Petitioner withheld the full amount of his commissions from Murton. There is no specific evidence in the record to support this finding. This is necessarily another inference drawn from the Court's original conclusion that there was an understatement of income. Thus we see that this inference is also dependent upon the original conclusion of

understated income. Until the Respondent is able to produce clear and convincing evidence that will justify the Court in making specific findings upon which it can validly base its conclusion that there was understated income, all three of its inferences of fraudulent intent are invalid, because each one of them is dependent upon the assumption that there was an understatement of income.

(3) The Court Should Not Have Rejected Petitioner's Testimony to the Effect That His Returns Were Honest, Correct and Complete.

The Tax Court stated that it rejected Petitioner's testimony "Because analysis of the record demonstrates the contrary". Apparently this is still the same "painstaking analysis" which we have dealt with earlier. We do not know what the analysis demonstrates because we do not have the analysis. We have only the Court's statement that it made such an analysis and as a result thereof came to the conclusion that there was undeclared income for the years in question. Until the Tax Court is able to make specific findings in support of its conclusions, the Petitioner's testimony stands unimpeached and uncontradicted. A somewhat similar situation is found in *Denny York v. Commissioner,* 24 T.C. 742. After holding that the Commissioner was justified in using the bank deposit method to determine the Petitioner's correct income and tax liability, the Court said,

> "The unexplained deposits may, as the Petitioner testified and as the Commissioner has not disproven, have included some funds which were held but not in the bank at the beginning of the

> year. . . . The Petitioner did not satisfactorily explain the deposits, indeed he made little or no effort to explain them, but this failure of the Petitioner does not make up the deficiency in the Commissioner's evidence to sustain the burden of proof of fraud placed upon him by the Statute."

The Tax Court cites *Drieborg v. Commissioner,* 225 Fed. 2d 216, 47 A.F.T.R. 1830, and we think the following quotation from that case is pertinent to the issue here:

> "At the outset it should be emphasized that the failure of the taxpayers to overcome the presumptive correctness of the deficiencies, even though those deficiencies cover a consecutive ten year period, cannot be regarded, in and of itself, as sufficient proof that the deficiencies, or any part thereof, were due to fraud on the part of the taxpayers. To hold otherwise would be to ignore the Statute which imposes on the Commissioner the burden of proving fraud and the often repeated admonition that such proof must be by clear and convincing evidence. . . . *There must be additional independent evidence from which fraudulent intent on the part of the taxpayer can be properly inferred."* (Emphasis added).

The dissent of Pope J. in *Showell v. Commissioner,* supra, states the applicable rule in the following language:

> "It is elementary that a disbelief of a witness' testimony does not serve to supply evidence that is simply not to be found in the record. "But

disbelief of the engineer's testimony would not supply a want of proof." *Moore v. Chesapeake & O. R. Co.,* 340 U.S. 573, 576. "Nor can the district judge's disbelief of petitioner's story of his motives and fears fill the evidentiary gap in the Government's case". *Nishikawa v. Dulles,* 356 U.S. ....., 2 L. ed. 659, 78 S. Ct. (March 31, 1958). The case of *Dyer v. MacDougall,* 2 cir., 201 F. 2d 265, 269, is a reasoned explanation of why this is so. There Judge Hand was commenting upon the fact that many things might convince a judge that a witness' testimony was not only false but that "the truth is the opposite of his story", yet the court went on to say that in that situation a disbelief of a witness' story is no substitute for required proof of what the facts are. In that case the court held there was a fatal lack of available proof simply because there were no witnesses available to testify as to the facts alleged."

There is no independent evidence of fraudulent intent in this case. Every inference of fraudulent intent is drawn from the Tax Court's conclusion, unsupported by any specific findings, that the Petitioner understated his income from commissions. The Tax Court's reiteration throughout its opinion that it is basing its holding upon the "entire record" merely means that it cannot point to any specific evidence in the record which supports the Respondent's position.

CONCLUSION.

For the reasons given in the foregoing argument the judgment of the Tax Court should be reversed and these proceedings remanded to that Court with instructions that judgment be entered for the Petitioner.

Dated, San Francisco, California,
July 15, 1958.

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
Attorneys for Petitioner.

(Appendix Follows.)

Appendix.

Appendix

Exhibits	For Identification	In Evidence
Petitioner's 6*	41	41
7	60	60
8	61	61
9	73	73
10	92	92
11	151	151
Respondent's S**	170	170

*Petitioner's Exhibits 1 through 5 and Respondent's Exhibits A through R are attached to the Stipulation of Facts.

**The Clerk erroneously labeled this Exhibit "F".

No. 15982

In the United States Court of Appeals for the Ninth Circuit

LESLY COHEN, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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In the United States Court of Appeals for the Ninth Circuit

No. 15982

LESLY COHEN, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 206-248) are not officially reported.

JURISDICTION

This appeal involves deficiencies in individual income taxes and statutory additions thereto (50% fraud penalties) as redetermined by the Tax Court in the aggregate sums of $168,533.92 and $91,127.42, respectively, totaling $259,661.34, plus interest according to law, for the three taxable years 1948-1950.[1] (R. 249.)

[1] The Tax Court's redetermination resulted in a total decrease of $1,530,605.43 in the taxpayer's income tax and fraud penalty liabilities for the three years involved, the Commissioner having initially determined and asserted against him deficiencies in income taxes and fraud penalties in the aggregate sums of $1,193,511.18 and $596,755.59, respectively, totaling $1,790,266.77, for those years. (R. 7-12, 207.)

On November 25, 1952, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiencies in the total amount of $1,790,266.77 for those years. (R. 7-12.) Within ninety days thereafter, and on March 4, 1958, the taxpayer filed a petition with the Tax Court for a redetermination of those deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 3-12.) The decision of the Tax Court redetermining the deficiencies in the total amount of $259,661.34 was entered on December 12, 1957. (R. 249.) The case is brought to this Court by the taxpayer's petition for review filed on March 4, 1954. (R. 250-257, 264.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court properly held that the Commissioner, in the absence of any *available* and/or adequate books or records kept by the taxpayer clearly showing income for the three taxable years 1948-1950 as required by law, correctly computed the taxpayer's taxable net income and the resulting deficiencies in income taxes for those years—to the extent redetermined by it—by the use of the so-called bank deposit method, under the provisions of Sections 22(a), 41 and 54(a) of the Internal Revenue Code of 1939.

2. Whether the Tax Court correctly found that part of the deficiencies in income taxes, as determined and asserted variously against the taxpayer by the Commissioner, was—to the extent redetermined by it—due to fraud with intent to evade the payment of income taxes for each of the taxable years 1948-1950, under the provisions of Section 293(b) of the 1939 Code.

STATUTES AND REGULATIONS INVOLVED

These are printed in the Appendix, *infra*.

STATEMENT

The facts, including those stipulated by the parties (R. 257-262) and incorporated in its findings of fact (R. 207), were found by the Tax Court substantially as follows (R. 207-221):[2]

Petitioner Lesly Cohen (hereinafter called the taxpayer), during the three taxable years 1948-1950 involved herein, resided in San Francisco, California, and was unmarried. He filed his individual tax returns for the calendar years 1948 through 1950 on a cash basis with the then Collector of Internal Revenue for the First District of San Francisco, California. (R. 207-208.)

The taxpayer was born and educated in San Francisco. He worked on a local newspaper, the San Francisco Bulletin, as a copy boy, and eventually became a sports writer and member of the sports staff. About 1934, when the Bulletin was sold to another publisher, he became a free-lance writer on sports subjects, editing boxing magazines and doing publicity work for various athletic events. (R. 208.)

During the taxable years in question, taxpayer lived modestly in his mother's home with two brothers and two sisters. During World War II, he was inducted into the United States Army. Upon his discharge, he returned to California and soon thereafter became ac-

[2] The facts relating to the issue in respect of certain of the taxpayer's losses from gambling allowed by the Tax Court to the extent of his gambling gains (R. 219-220, 229)—not appealed by the Commissioner—are included herein the more clearly to show the complete picture as to the other issues involved upon review.

quainted with one Coplin, a so-called "betting commissioner", who owned and operated the Kingston Club (111 Ellis Street), in San Francisco. A "card room" was maintained as part of the club's operations. The same premises were used by Coplin for his "betting commissioner" business, which consisted largely of placing bets on horse races on a commission basis. The latter venture was in violation of both State and local law. Coplin, desirous of expanding his gambling activities to embrace other athletic events, invited the taxpayer to join his betting commissioner enterprise as a limited partner. (R. 208.)

In the latter part of 1947, Coplin died, and about January, 1948, the taxpayer took over the operation of the Kingston Club. Thereafter, until the latter part of 1951, when the Federal gambling stamp tax law was put into effect, the taxpayer operated the club's card room and betting commissioner activities as sole proprietor. During the years 1948, 1949 and 1950, his activities as betting commissioner included not only horse racing but other sports events. He was unable to estimate what proportion of the bets handled by him grew out of horse racing and what proportion out of other sports events. Taxpayer's activities as betting commissioner and his operation of the card room were his only income-producing activities during the years in question, other than a small amount of income derived from investments in securities with his brother Herbert. In his personal gambling activity at the Film Row Club, his losses exceeded his gains. The gains and losses from his limited activities as bookmaker about balanced each other. (R. 208-209.)

The taxpayer's primary function as betting commissioner was to obtain opposite parties to a wager, receiv-

ing for his services a "commission" or fixed percentage of the amount involved in the wager. Ordinarily, Lesly would quote prevailing odds on horse races and other athletic events and if a customer wished to make a wager, taxpayer would attempt to locate others to accept or "cover the bet" in the same amount. Normally, taxpayer did not accept a wager as "placed" until he had found some other individual to "lay off" the other side of the same event. When taxpayer was able to "lay off" the entire amount of the bet, his profit or loss would not depend upon the outcome of the event, but would be a fixed percentage or "commission" of the total wager, which he retained on each bet. When able to do so, taxpayer would lay off the bet with one or more of his own local customers. When this could not be accomplished, he would lay off or cover the bet with other betting commissioners in the San Francisco Bay area and in other cities. He would not bring the customers betting on opposite sides of the same transaction into personal contact so that they could bet with each other. When Lesly located a client willing to accept the other side of a bet, he would confirm acceptance of the wager by telephone. Lesly was personally responsible for the collection of all betting commitments which he made, and had to pay the winner even if he was unable to collect from the loser. The taxpayer watched his credits closely. (R. 209-210.)

The commission to taxpayer on bets handled for his own customers was 5% on each bet handled by him, except that on horse racing bets only the loser paid a commission. These commissions were not split. On bets laid off with other betting commissioners, the commission was usually split, one-half going to taxpayer. At times, he found it necessary to waive his entire

commission in order to get the bet laid off with another betting commissioner. (R. 210.)

Occasionally, through miscalculations on taxpayer's part or other unforeseen circumstances, he accepted a bet and could not arrange to lay it off. He then found it necessary to carry the other part of the bet. On these occasions, he acted as bookmaker to the extent that he himself carried the bet. Except for such occasional instances, he did not carry any part of the bet himself. (R. 210-211.)

The taxpayer's betting commissioner enterprise was operated almost entirely on a credit basis. Comparatively insubstantial amounts of money were actually posted with taxpayer prior to the happening of the event which determined the wager. Normally taxpayer collected cash from local bettors and paid local winners in cash. Cash settlements were made with local customers following the happening of the sporting event. Settlements with other commissioners in the San Francisco area were likewise mainly in cash. Transactions with out-of-town betting commissioners were generally settled at periodic intervals by check. The periods varied and included settlements on a daily, weekly or monthly basis, or when the account reached a certain fixed sum in favor of taxpayer or the out-of-town broker. Such settlements were in effect the balancing of accounts between taxpayer and out-of-town betting commissioners. They usually represented the net amount due from a number of bets rather than a single bet. When it was necessary for taxpayer to remit to an out-of-town broker to settle an account, taxpayer usually sent his own personal check. Occasionally he was required to send cashier's checks. The taxpayer was unable to estimate what proportion of his betting com-

missioner transactions were with out-of-town brokers. The handling of bets of local customers as betting commissioner on a commission basis was a substantial part of taxpayer's business. (R. 211-212.)

The taxpayer maintained a "revolving fund" of about $3,000 in cash, which he used in making pay-outs to local winners. Checks, most of which were received from out-of-town brokers, were either deposited in taxpayer's commercial bank account or were endorsed and transferred, or cashed by taxpayer. The only cash deposits in taxpayer's commercial bank account during the years in question were, in the aggregate: $430 during 1948, $8,470 during 1949, and $13,955 during 1950. The taxpayer received cash from local bettors far in excess of the foregoing amounts in each of those respective years. His records of cash transactions as betting commissioner were kept only a few days until settlement was made. He never furnished to his accountant any records of his cash transactions or cash commissions received as betting commissioner. In preparing data for taxpayer's income tax returns for the years in question, neither the accountant who assembled the data nor the accountant who prepared the returns from such data took into consideration any undeposited cash. (R. 212.)

Throughout the years 1948, 1949 and 1950, taxpayer maintained a commercial bank account in the name of "Les Cohen" at the Market-Ellis Branch of the Anglo-California National Bank, San Francisco, California, where he deposited funds relating primarily to his activities as betting commissioner. The total deposits to taxpayer's commercial account in that bank for each of the years involved herein were in the following amounts: $508,384.23 for 1948, $404,118.69 for 1949, and

$283,129.80 for 1950. (R. 212-213.) Those deposits largely represented the taxpayer's receipts from other betting commissioners in settlement of accounts. (R. 213.)

The foregoing deposits consisted almost entirely of checks. During the entire three-year period in question the total amount of cash included in such deposits (detailed, *supra*, by years) was less than $25,000. Deposits totaling $2,905 were made to the bank account on January 3, 1951. (R. 213.)

During each of the years in controversy, taxpayer received a large number of checks payable to "Les Cohen" which were endorsed by him but not deposited. The total amounts thereof and the respective years in which received were $120,974.75 for 1948, $107,712 for 1949, and $22,613.75 for 1950. These undeposited checks likewise largely represented settlement of accounts. (R. 213.)

The taxpayer made payments by check in the settlement of accounts with out-of-town bettors totaling $292,283.46 in the year 1950.[3] (R. 213.)

During the taxable years in question, the taxpayer did not maintain any permanent or detailed records or formal books reflecting gross commissions or gross receipts and disbursements from his betting commissioner activities. Taxpayer was apprehensive that the possession of such records would be both incriminating to him and embarrassing to his customers if they fell into the hands of the law enforcement officers. For his own reference purposes, however, he kept a daily

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[3] The taxpayer, in his proposed Finding No. 50, and the Commissioner, in his proposed Finding No. 83, took the position, in effect, that payments in unspecified amounts were made under similar circumstances in 1948 and 1949. (R. 213.)

"master sheet" at the Kingston Club setting forth the transactions which he handled as betting commissioner. On a busy day, approximately 100 wagers were recorded thereon. After a day or two, when the master sheets had served their immediate purpose, they were destroyed to avoid possible seizure and use as evidence by police authorities. The effect of such destruction was likewise to render it impossible to make an accurate determination of the amount of his commissions received as betting commissioner. No record of such commissions was maintained by taxpayer. (R. 214.)

The taxpayer retained George T. Murton (formerly the accountant for the Kingston Club during the years Coplin operated the club) to maintain its records, and Murton, or Evje, an accoutant in Murton's firm, performed such service for the taxpayer during the years in question. (R. 214.)

Murton's procedure was to go to the Kingston Club at least once a month and take off the record of income and disbursements from the card room. He also collected memorandum sheets upon which the taxpayer had noted daily cash expenditures. Receipts or paid bills were usually attached. Murton took the bank statements and canceled checks and reconciled the bank statements with the check book stubs. The books of account of the card room were either used at the card room by Murton or taken to his office and returned to the card room where they were kept. The bank statements, canceled checks and memoranda of cash expenditures were kept by Murton either at his home or in his office. Murton compiled the results of his accounting work in a so-called ledger which was actually a compilation on columnar work sheets. (R. 214-215.)

Murton's method of arriving at taxpayer's gross income at the end of each year was as follows: He subtracted the amount in the bank at the beginning of the year from the amount in the bank at the end of the year. He then added to the net increase or decrease in the bank balance all of the expenses of the business and all of the withdrawals made by or for the taxpayer. The result was considered taxpayer's gross income from the Kingston Club. (R. 215.)

The accountants disregarded cash receipts (other than those deposited and reflected in the bank balance) and also disregarded cash payouts except those payouts substantiated by a memoradum from taxpayer. This was done on the theory that the $3,000 revolving fund remained approximately the same throughout the period. From the gross income thus arrived at Murton would deduct the taxpayer's deductible expenses. (R. 215-216.)

Petitioner did not inform Murton that he received a substantial amount of checks in each of the years in question in connection with his business as betting commissioner which he endorsed but did not deposit. (R. 216.)

For about five months in 1950, while Murton was ill, accountant Evje acted in his place and followed the same methods. Evje never saw any books recording cash receipts or betting records relating to taxpayer's activities as betting commissioner. Murton died some time in 1951. (R. 216.)

All business expenses listed on Murton's summaries and claimed as deductions on taxpayer's returns were allowed by the Commissioner. (R. 216).

Annual summary sheets were prepared by Murton and furnished to taxpayer and mailed to Calegari, a

certified public accountant who prepared the taxpayer's income tax returns. The summary sheets for the three years here involved were furnished by Murton to accountant Calegari and were used by the latter in the preparation of the taxpayer's income tax returns. Calegari did not keep any books or records for the Kingston Club operations or for any of taxpayer's betting commissioner activities. The only records maintained by Calegari relating to taxpayer's financial affairs were a set of books for Lesly's investment in various stocks and bonds, which he held as a joint venturer or partner with his brother Herbert. (R. 216-217.)

In the preparation of taxpayer's income tax returns for the years in question, Calegari was not given access to any books or records that may have been maintained with respect to the Kingston Club or for any of taxpayer's betting activities. In preparing taxpayer's income tax returns, Calegari relied on the annual summary sheets and profit and loss statements of the Kingston Club operations, which were sent to him by Murton. (R. 217.)

About the end of 1950, taxpayer's Federal income tax returns for the years 1948 and 1949 were audited by Internal Revenue Agent Parenti. The bank statements, cancelled checks and memoranda of cash expenditures referred to above, used in the preparation of the summary sheets for 1948 and 1949 by Murton, had been kept by the latter either at his home or in his office, and were made available to Revenue Agent Parenti. (R. 217.)

Revenue Agent Parenti based his examination of taxpayer's returns for 1948 and 1949 entirely on information and data furnished by accountant Evje of

Murton's office. After Agent Parenti audited taxpayer's returns for the years 1948 and 1949, he prepared and filed a report indicating deficiencies of $5,505.67 for 1948 and $4,689.23 for 1949. (R. 217.)

At the time of the trial in the instant case, the bank statements and cancelled checks for the years 1948 and 1949 could not be found. The taxpayer was able to produce only his cancelled checks for the last 11 months of 1950 and bank statements for the year 1950. (R. 217-218.)

In 1952, Internal Revenue Agent Glenn Adrian conducted an original examination of taxpayer's income tax return for 1950 and a re-examination of his 1948 and 1949 returns. At this time there was a nationwide investigation of betting commissioners and others engaged in gambling activities. As a result of this drive, Revenue Agent Adrian had acquired, at the time of his investigation, photostat copies of checks paid to or endorsed by "Les Cohen", which had been received from other revenue agents' offices throughout the United States. Many of those checks had been endorsed and cashed by taxpayer and had not been deposited in his commercial bank account. This information had not been available at the time of Revenue Agent Parenti's examination in 1950. (R. 218.)

Revenue Agent Adrian obtained authorization from the Commissioner of Internal Revenue for a re-examination of taxpayer's returns for 1948 and 1949, and a copy of the letter of authorization was furnished to taxpayer. At the beginning of his examination, Agent Adrian contacted accountant Calegari and was advised by him that taxpayer's attorney had all of taxpayer's existing books and records. Later, an agent of the Intelligence Division of the Internal Revenue Service

communicated with taxpayer's attorney and was informed that the attorney had all of the taxpayer's books in his office. In May, 1952, Revenue Agent Adrian caused a registered letter to be sent to taxpayer requesting that he produce his records, and a follow-up letter was sent to taxpayer in September of 1952. The taxpayer neither answered the letters nor produced his books and records. Thereafter, Agent Adrian contacted taxpayer's attorney who informed the agent that he would look at the records in his possession and would let Adrian know whether he could see them. Later the attorney informed Agent Adrian that he had looked at the records and that he would not show Adrian anything. (R. 218-219.)

Revenue Agent Adrian proceeded to make his audit on the basis of third-party records to the extent that they were available. The available records were (1) bank deposit tags which showed dates and amounts of deposits and a number identifying the banks on which the deposited checks were drawn, but no names identifying the makers of the checks; (2) copies of bank statements of taxpayer's accounts showing total deposits, and amounts and dates of payment of checks drawn on the account, but without names or other identification of payees; (3) photostat copies of checks payable to Les Cohen obtained from other internal revenue agents' offices; and (4) a transcript of an account on the books of the Film Row Club showing taxpayer's wins and losses from personal bets at that club. (R. 219.)

The taxpayer's wins and losses from gambling at the Film Row Club were as follows (R. 219):

Year	Amount Won	Amount Lost
1948	$61,695.00	$79,075.00
1949	63,500.00	69,912.50

The Commissioner computed taxpayer's taxable income for the years in question by the so-called bank deposit method. He determined that all monies deposited in the commercial bank, all checks received and endorsed but not so deposited (to the extent he had knowledge of them at the time the statutory notice was mailed), and all wins from the Film Row Club constituted income. Because of lack of substantiation, no deductions were allowed for pay outs or losses. None of the deductions claimed on taxpayer's returns were disallowed. (R. 220.)

Revenue Agent Adrian did not attempt to compute taxpayer's net income by the so-called net-worth method because taxpayer dealt in large sums of cash and the agent did not feel that he could accurately determine net worth for that reason and also because, having been refused taxpayer's books, he would not know how taxpayer made his investments. (R. 220.)

In taxpayer's tax returns for 1948 through 1950, on Schedule C, page 2 (profit or loss from business), the nature of the business was stated to be "brokerage". (R. 220.)

Gross profits (listed as total receipts) from the Kingston Club operations were reported on taxpayer's tax returns for the years 1948 and 1949 in the amounts of $56,795.13 and $66,274.91, respectively. On taxpayer's original income tax return for the year 1950, he reported gross profit (listed as total receipts) from Kingston Club in the amount of $1,836.28, and a net loss of $26,687.91. On July 28, 1954, taxpayer filed an amended return for the year 1950 on which he reported gross income (listed as total receipts) from Kingston Club of $8,207.71 and a net loss of $15,125.75. (R. 220-221.)

During the years involved herein the taxpayer had a safe deposit box at the Bank of America, Day and Night Branch. (R. 221.)

During each of the taxable years in question, the taxpayer received substantial commissions in cash from local customers. His settlements with local betting commissioners were almost entirely in cash, and reflected his share of commissions. (R. 221.)

The taxpayer's gross income from his activities as betting commissioner and the operation of the Kingston Club card room for the respective years in question did not exceed the following: $167,000 for 1948, $145,000 for 1949, and $108,000 for 1950. (R. 221.)

The taxpayer, in his income tax returns for each of the years in question, substantially understated income from his activities as betting commissioner and the operation of the Kingston Club card room. (R. 221.)

A part of the deficiency for each of the three years involved was due to fraud on the part of taxpayer with intent to evade taxes, within the meaning of Section 293(b) of the Internal Revenue Code of 1939. (R. 221.)

Upon the basis of the foregoing facts, the Tax Court, sustaining the Commissioner's determinations in part (R. 221-248), held that (1) the Commissioner, in the absence of any available books or records kept and/or made available by the taxpayer clearly reflecting his true income for the taxable years involved as required by law, correctly computed the taxpayer's taxable income and the resulting deficiencies in income taxes—to the extent redetermined by it—by the use of the bank-deposit method for those years (R. 221-228), (2) the Commissioner properly determined that the taxpayer had grossly understated his taxable income and the amounts of such understatements on his tax returns—to

the extent redetermined by the Tax Court—for each of the three taxable years involved (R. 228-243), and (3) part of the deficiencies in income taxes as determined and asserted against the taxpayer by the Commissioner was—to the extent redetermined by it—due to fraud with intent to evade the payment of income taxes for each of the taxable years 1948-1950 (R. 243-248). 1957 P-H Tax Court Memorandum Decisions, par. 57.172, decided September 12, 1957. The Tax Court thereupon entered its decision accordingly on December 12, 1957 (R. 249), from which the taxpayer petitioned this Court for review on March 4, 1958 (R. 250-256).

SUMMARY OF ARGUMENT

1. The taxpayer's corrected net income was properly ascertained and determined by the Commissioner—to the extent redetermined by the Tax Court—by the use of the bank deposit method. The evidence revealed the source of the taxpayer's understated, unreported income as having come from his extensive, lucrative gambling-business operations during the three taxable years involved when he made very substantial amounts of deposits in his checking account during each year, received certain undeposited checks which he cashed or endorsed and transferred to others without their being deposited in his bank account, and also from large winnings from gambling in the Film Row Club during each of the taxable years 1948 and 1949. The taxpayer was given every opportunity to explain the large understatements of income uncovered by the Commissioner's revenue agents but he declined to do so by honest reliable testimony, even to the extent of refraining from introducing his records (in his attorney's possession) in evidence. The Tax Court,

notwithstanding, made generous allowances in his behalf and otherwise redetermined his taxable income under the best-estimate approximation rule as authorized by the decisions of this Court and other Courts of Appeals. Since the taxpayer could not—or would not—explain the remaining discrepancies between his reported income and his unreported income as reconstructed by the bank deposit method, the Tax Court was not required to accept his unsupported statements, indeed found it necessary to reject his testimony as being, in the light of the record, wholly unconvincing and untrue. Hence, on the evidence before it, the Tax Court had no alternative than to find that the unexplained discrepancies represented understated, unreported taxable income for the three taxable years involved.

2. As to fraud, the Commissioner determined and established and the Tax Court found fraud accordingly for the taxable years 1948-1950 based on the following grounds: (a) the taxpayer's failure to keep any books or records clearly reflecting taxable income for those years, though required by law to do so, (b) his refusal to turn over such records as he did have to the Commissioner's revenue agents before and while investigating his income tax returns for the taxable years involved, as well as his refraining from introducing them in evidence at the hearing in the Tax Court, (c) his testimony which the Tax Court found necessary to reject as not being honest, correct and/or complete because an analysis of the record demonstrated the contrary, and (d) his failure to have reported taxable income aggregating $288,722.25 over the period of the three consecutive years involved, an annual average of understated income of more than $96,000, his tax-

able income ($288,722.25) for the three-year period having been more than eight times the total amount ($35,436.49) reported by him for those years. These items, together with other facts of record, constitute ample evidence to support the Tax Court's findings of fraud on the part of the taxpayer with intent to evade the payment of income taxes for all three years involved. The Tax Court found that the Commissioner met his burden of establishing fraud, nor did the taxpayer produce anything to disprove it.

ARGUMENT

I

The Record Amply Sustains the Tax Court's Redetermination of the Deficiencies for the Three Taxable Years Involved

The question presented here is whether the Tax Court properly held that the Commissioner, in the absence of any available and/or adequate books or records kept by the taxpayer clearly showing income for the taxable years 1948-1950 as required by law, correctly determined the taxpayer's taxable net income and the resulting deficiencies in income taxes—to the extent redetermined by it—by the use of the so-called bank deposit method for those years, under the pertinent provisions of the taxing statute. The taxpayer contends that the Tax Court erred in thus sustaining the Commissioner's determination to the extent redetermined by it (Br. 26-53), and we submit that his contentions are without merit.

A. *The Tax Court did not err in sustaining the Commissioner's determination of the taxpayer's unreported taxable net income and the resulting deficiencies—to the extent redetermined by it—for the three taxable years involved by the use of the bank deposit method*

If the taxpayer does not keep adequate books and records which "clearly reflect the income" for the taxable years involved as required by law, as the Tax Court found here (R. 214), the taxing act authorizes the Commissioner to compute his income by whatever method "in the opinion of the Commissioner does clearly reflect the income". Sections 22(a) and 41 of the Internal Revenue Code of 1939; Sections 29.22(a)-1, 29.41-1 and 29.41-3 of Treasury Regulations 111, all Appendix, *infra*. Moreover, the taxpayer is not only required to keep such permanent books of account or records clearly reflecting income but also to maintain them "at all times available for inspection" by the Commissioner's revenue agents and to retain them "so long as the contents thereof may become material in the administration of any internal-revenue law". Section 54(a) of the 1939 Code; Section 29.54-1 of Treasury Regulations 111, both Appendix, *infra*. The record here shows that taxpayer during the three taxable years involved concededly carried on extensive, lucrative business operations—much of which was handled by cash transactions—as a betting commissioner, made very substantial amounts of deposits in his checking account during each year, received certain undeposited checks which he cashed or endorsed and transferred to others during each year, and realized large winnings from gambilng in the Film Row Club during each of the years 1948 and 1949. Yet

the taxpayer neither kept adequate records showing the income realized from such gambling-business operations nor did he make such records as he did keep (though wholly inadequate) available for inspection and examination by the Commissioner's revenue agent who investigated his tax returns for the three taxable years involved. (R. 214, 218-219, 221-222, 227, 230.)

In these circumstances, it is clear that the Commissioner was fully justified in resorting to the taxpayer's bank deposits and other third-party sources in order to reconstruct and compute his understated, unreported taxable income, to the fullest extent possible under the circumstances, for each of the three taxable years involved. *Holland* v. *United States,* 348 U.S. 121, 130-132, rehearing denied, 348 U.S. 932; *Sterns* v. *Commissioner,* 235 F. 2d 584 (C.A. 9th); *Gobins* v. *Commissioner,* 217 F. 2d 952 (C.A. 9th), affirming *per curiam* 18 T.C. 1159; *Rose* v. *Commissioner,* 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th); *Doll* v. *Glenn,* 231 F. 2d 186, 188 (C.A. 6th); *Thomas* v. *Commissioner,* 223 F. 2d 83, 86 (C.A. 6th); *Bodoglau* v. *Commissioner,* 230 F. 2d 336 (C.A. 7th); *Cohen* v. *Commissioner,* 176 F. 2d 394 (C.A. 10th); *Goldberg* v. *Commissioner,* 239 F. 2d 316 (C.A. 5th). Nor is the Commissioner's use of the bank deposit method in determining the existence of unreported income limited to situations where the taxpayer has or makes available no adequate books or records, as here, for the Government is at liberty to use any and all legal evidence available to it in determining whether the story told by the taxpayer's books and records accurately reflects his financial history and taxable income. *Holland* v.

United States, supra. There the Supreme Court stated in this connection (p. 132):

> Certainly Congress never intended to make Section 41 a set of blinders which prevents the Government from looking beyond the self-serving declarations in a taxpayer's books. "The United States has relied for the collection of its income tax largely upon the taxpayer's own disclosures * * * This system can function successfully only if those within and near taxable income keep and render true accounts." *Spies* v. *United States,* 317 U.S., at 495. To protect the revenue from those who do not "render true accounts," the Government must be free to use all legal evidence available to it in determining whether the story told by the taxpayer's books accurately reflects his financial history.

It has long been settled by this Court and by the other Courts of Appeals that, under circumstances such as those here involved, the Commissioner, having no alternative, is at liberty to determine taxable income from third-party records and other sources in order to establish, as accurately as possible, the true income, and therefore is warranted in treating as taxable income any unexplained excess of bank deposits over nontaxable and reported income. Section 41 of the 1939 Code; Section 29.41-1 of Treasury Regulations 111; *Gobins* v. *Commissioner, supra; Sterns* v. *Commissioner, supra; Rose* v. *Commissioner, supra; Roberts* v. *Commissioner, supra; Halle* v. *Commissioner,* 7 T.C. 245, affirmed, 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; *Hague Estate* v. *Commissioner,* 132 F. 2d 775 (C.A. 2d), certiorari de-

nied, 318 U.S. 787; *Goe* v. *Commissioner,* 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Mauch* v. *Commissioner,* 113 F. 2d 555 (C.A. 3d); *Stoumen* v. *Commissioner,* 208 F. 2d 903 (C.A. 3d); *Greenfeld* v. *Commissioner,* 165 F. 2d 318 (C.A. 4th); *Boyett* v. *Commissioner,* 204 F. 2d 205, 208 (C.A. 5th); *Miller* v. *Commissioner,* 237 F. 2d 830 (C.A. 5th); *Doll* v. *Glenn,* 231 F. 2d 186, 188 (C.A. 6th); *Hoefle* v. *Commissioner,* 114 F. 2d 713 (C.A. 6th); *Traum* v. *Commissioner,* 237 F. 2d 277 (C.A. 7th); *Marcella* v. *Commissioner,* 222 F. 2d 878 (C.A. 8th); *Cohen* v. *Commissioner,* 176 F. 2d 394 (C.A. 10th); *Moriarty* v. *Commissioner,* 18 T.C. 327, affirmed, 208 F. 2d 43 (C.A. D.C.); *Jacobs* v. *United States,* 126 F. Supp. 154, 157 (C. Cls.[4]). In *Boyett* v. *Commissioner, supra,* the Fifth Circuit said (p. 208), "Where, as here, the records kept by the taxpayer are manifestly inaccurate and incomplete, the Commissioner may look to other sources of information to establish income". To the same effect, see *Greenfeld* v. *Commissioner, supra.*

It is equally well settled by the foregoing cases that the Commissioner's determination of the corrected net

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[4] Substantially to the same effect are the decisions authorizing the Commissioner's computation and determination of taxable income, in the absence of books and records clearly showing income, by the so-called net worth method. *United States* v. *Johnson,* 319 U.S. 503, rehearing denied, 320 U.S. 808; *Holland* v. *United States, supra; Friedberg* v. *United States,* 348 U.S. 142, rehearing denied, 348 U.S. 932; *Smith* v. *United States,* 348 U.S. 147; *United States* v. *Calderon,* 348 U.S. 160. The Commissioner's Revenue Agent Adrian investigating the taxpayer's returns in the instant case, however, did not attempt to compute his taxable income by the net worth method because the taxpayer dealt in large sums of cash and Agent Adrian did not feel that he could accurately determine the net worth by that method for that reason and also because, having been refused access to the taxpayer's books and records, he would not know how the taxpayer made his investments (R. 196), as the Tax Court found (R. 220).

income was presumptively correct and the burden was on the taxpayer to show that it was wrong, that the Tax Court was not obligated to accept the taxpayer's uncorroborated testimony regarding his receipts and expenditures, and that the Tax Court's finding that the taxpayer grossly understated his taxable income may not be disturbed upon appeal unless clearly erroneous. See also, *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; *Quock Ting* v. *United States,* 140 U.S. 417.

Accordingly, it is clear that the Tax Court did not err in sustaining the Commissioner's determination of the taxpayer's understated, unreported income by the bank deposit method—to the extent redetermined by it—and in holding that such determination was neither arbitrary nor invalid. (R. 221-228.)

B. *The amounts of the taxpayer's understatements of unreported income and the resulting deficiencies were properly computed by the Commissioner—to the extent redetermined by the Tax Court—for each of the three taxable years involved*

In harmony with the consistent rule laid down by this Court and the other appellate courts in the series of analogous cases above mentioned, the Commissioner's Revenue Agent Adrian in early 1952 began his investigation of the taxpayer's income tax returns for the three taxable years 1948-1950 in order to ascertain and reconstruct his true income by the bank deposit method. (R. 190 *et seq.,* 220.) In the absence of any books or records clearly showing income kept by the taxpayer (R. 212, 214-215) and because of the refusal of the taxpayer's attorney to show him any of the taxpayer's records which he had in his possession (R. 173-174, 175,

177, 188-189, 196, 197, 204-205, 219, 227), as pointed out, Revenue Agent Adrian made his computations of the taxpayer's income on the basis of third-party records and other sources to the extent available (R. 219). These constituted (1) bank deposit tags showing dates and amounts of the taxpayer's deposits aggregating $1,195,632.72 for the years 1948-1950 (R. 190-194, 212-213, 219, 258-259), (2) copies of bank statements of the taxpayer's accounts showing total deposits and the amounts and dates of payments of checks drawn thereon but without names or other identification of the payees (R. 190 *et seq.,* 212-213), (3) copies of checks payable to the taxpayer (obtained from other offices of the Internal Revenue Service) in the aggregate sum of $251,300.50 for the three taxable years involved (R. 191-194, 213, 259-262), and (4) a transcript of the account on the Film Row Club's books showing the taxpayer's winnings ($125,195) and losses ($148,987.50) from his personal bets at that Club (R. 194-195, 196-197, 209, 219, 229). In so doing, Revenue Agent Adrian determined that all monies deposited by the taxpayer in his commercial bank account (R. 212-213), all checks received and endorsed but not so deposited by the taxpayer, and all winnings from the Film Row Club, constituted income (R. 190 *et seq.*[5]) as the Tax Court found (R. 220, 229).

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[5] Revenue Agent Adrian, in his computations, did not disallow any of the deductions claimed by the taxpayer on his tax returns for the taxable years involved nor, for lack of substantiation, did he allow any of the taxpayer's claimed deductions taken for pay-outs or gambling losses from the Film Row Club. (R. 195, 196-197, 201, 204-205, 220.) The Tax Court, however, while not directly allowing any of the taxpayer's pay-outs as offsets against deposits for any of the taxable years involved, for lack of substantiation (R. 225-226, 230), did make such allowances by indirection

Pursuant to the foregoing, Revenue Agent Adrian, in the absence of books or records kept by the taxpayer and without the benefit of the records the taxpayer did have, such as they were—which his attorney refused to turn over to him for use in the investigation—and finding the net worth method inadequate under the circumstances of this case, reconstructed and computed the taxpayer's net income from his various gambling operations for the taxable years as best he could by the use of the bank deposit method, as pointed out, thereby arriving at the total net amounts of $717,889.68, $578,-219.42 and $301,249.86, aggregating $1,597,358.96, for those years, respectively. These were the amounts determined and asserted against the taxpayer by the Commissioner in his statutory notice of deficiencies for the taxable years involved. (R. 7-12, 197, 202.) The record shows that in arriving at these figures, Revenue Agent Adrian, without access to the taxpayer's books and records, as pointed out, did the following—to large extent as shown by the stipulated facts (R. 257-262)—in ascertaining the taxpayer's taxable income for the three taxable years in question: Agent Adrian first made schedules from the bank's records of the tax-

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(R. 235, 236, 237). It also allowed the taxpayer's gambling losses to the extent of his gains for the years 1948 and 1949—this issue not being involved for the year 1950 (R. 229)—but correctly sustained the Commissioner's disallowance of any deductions for the excess of losses over wins for those years (R. 229). The statute provides that "Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions." Section 23(h) of the Internal Revenue Code of 1939; Section 29.23(h)-1 of Treasury Regulations 111. In any event, the taxpayer concedes that the Tax Court's "refusal to allow the excess of losses over wins was correct", adding, "Incidentally, Petitioner never contended before the Tax Court that the excess of losses [over wins] should have been allowed as a deduction". (Br. 39.)

payer's commercial bank account showing all deposits and checks written against the account as made by him during the three years in question (R. 190-191, 202, 258-259; Ex. 5-E). He thereupon made a complete analysis of the taxpayer's deposit tags identifying all items making up the deposits in his account. Against this, he checked all the taxpayer's available checks (copies of which Agent Adrian had) to determine whether they had been deposited or undeposited, and then separated them into two different schedules showing the total of the checks deposited—to the extent located and available [6]—and the total of the checks which had been cashed or endorsed over to others but not deposited, respectively. (R. 191-193, 258-262; Exs. F-I, K-R.) With the information and data thus gathered, Agent Adrian combined the totals of his verified schedules of deposited and undeposited checks, as found by him during his investigation, with the totals of the additional deposited and undeposited checks (not before available to or considered by him) as stipulated to by the parties, respectively. (R. 261-262; Ex. R.) He thereby determined that the taxpayer had deposited checks in the total sum of $1,195,632.72, and also had received and cashed or endorsed to others but not deposited checks totaling $251,300.50, aggregating $1,446,933.22, for the three taxable years involved. (R. 194, 212-213.) To the total amount of deposited and undeposited checks thus ascertained, plus total cash

[6] Agent Adrian was able to locate approximately one-fifth of the checks deposited by the taxpayer during the taxable year 1948 and about one-half of those deposited during the years 1949 and 1950. (R. 192-193.) The remaining checks, as stipulated (R. 258-262), not theretofore available to Revenue Agent Adrian, were received in his office after he had completed his examination of the taxpayer's returns for the taxable years involved (R. 193, 203-204).

($22,895) deposited in the taxpayer's bank account during the taxable years involved (R. 194, 212), Agent Adrian added the taxpayer's "wins" (totaling $125,-195) from the Film Row Club for the taxable years 1948 and 1949 (R. 195, 196, 197, 219, 229), thus arriving at the grand total of $1,595,023.22 representing taxable income chargeable to the taxpayer for the three taxable years involved, "and that was the figure which was used in the computation of the tax in each of the [three taxable] years considered" by him (R. 194). This, together with the additional information and data received by the Commissioner after Agent Adrian's investigation and report thereof (R. 193, 203-204, 221-222), formed the basis of the Commissioner's deficiency notice sent to the taxpayer on November 25, 1952 (R. 7-12, 197, 202), as pointed out. In these computations, moreover, Agent Adrian, as in the case of the taxpayer's gambling losses, made no allowance for the taxpayer's "payouts", for lack of substantiation (R. 195, 201), nor, for the same reasons, did the Commissioner in his determination of deficiencies make any allowanes therefor (R. 8-12, 225-226 [7]).

In view of the foregoing, it cannot properly be said that the Commissioner's revenue agent, in the absence of any books or records kept and/or made available by the taxpayer, did anything other than what was necessary in order to compute the taxpayer's taxable income by the bank deposit method. The taxpayer, on the other hand, had reported on his income tax returns as filed for the taxable years involved net income of only

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[7] Neither did the Tax Court—except for gambling losses (R. 225, 229)—for the same reasons (R. 220, 225-226, 230, 235, 236-237), except to an undisclosed extent by indirection (R. 235, 236, 237). (See fn. 5, *supra*.)

$24,540.94 and $35,740.69 and a loss of $24,845.14, respectively, aggregating net income reported of $35,436.49—an average of only $11,812.16—for the three taxable years. (R. 9-11.) Accordingly, the Commissioner properly determined that the taxpayer, in thus reporting far less than his true income, had grossly understated his taxable net income for all years involved.

C. *The Tax Court properly redetermined the volume of the taxpayer's bets handled and the gross commissions received thereon on the basis of his bank deposits for each of the three taxable years involved*

The Tax Court, in the absence of any adequate books or records kept or made available by the taxpayer, used the taxpayer's bank deposits for the purpose of redetermining the volume of his out-of-town bets handled as betting commissioner and, in turn, his gross commissions received thereon for each of the three taxable years involved. (R. 229-243.[8]) In so doing, the

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[8] The record shows that the taxpayer's only "income-producing activities during the [taxable] years in question" were those carried on as betting commissioner and his operation of the Kingston Club card room (except for a small amount of income derived from investments in securities with his brother, not in dispute here), and that his gross commissions from such activities and net understatements thereof in his returns were determined by the Tax Court on the basis of his bank deposits. (R. 209, 221, 229-238.) In the absence of any showing of separate income or loss from the taxpayer's operations of the Kingston Club card room (R. 209), moreover, the Tax Court, in its redetermination of the taxpayer's gross income and understatements thereof with respect to his activities as betting commissioner, included therein "any income or loss from the Kingston Club card room" (R. 237-238). The taxpayer's other income (gains from his personal gambling activities at the Film Row Club) was exceeded by his losses sus-

Tax Court, on the basis of the taxpayer's total deposits of checks and money orders and checks received and cashed or endorsed to others, representing remittances from out-of-town betting commissioners with whom he had placed lay-off bets which he had been unable to place locally, and with whom he had credit balances in his favor, and also checks issued in *net* settlement of accounts (embracing wins, losses and commissions (R. 232)), determined a substantial portion of the taxpayer's gross commissions received on lay-off bets for each of the taxable years involved (R. 231-237). The record shows that the taxpayer's deposits, though "largely representative of the settlement of [his credit balances for] bets laid off" with out-of-town betting commissioners, did not represent all of the bets thus laid off with foreign commissioners for he also received other checks in substantial amounts in net settlement of accounts during each taxable year which, as pointed out, he either cashed or endorsed over to others but did not deposit, and on the basis of which the Tax Court redetermined the remaining portion of the taxpayer's gross commissions received during those years. (R. 232-233, 235-236, 237.) Likewise, the taxpayer issued substantial checks during each taxable year to out-of-town betting commissioners in net settlement of accounts having credit balances in their favor. (R. 233, 236, 237.[9]) In this connection, the Tax Court found (R. 233) that—

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tained therein (R. 209, 219, 229), and was determined by the Commissioner and the Tax Court from the transcript of the records of the Film Row Club as furnished the Commissioner's revenue agent by that Club (R. 195).

[9] The amounts of such net settlement checks issued by the taxpayer during the taxable years 1948-1949 are not in the record but they were determined by the Tax Court for those years on the

> The total of checks deposited, checks cashed or endorsed, and checks issued *represents a minimum of layoff bets,* because, as already indicated [R. 231-232], they represented [net] settlement of accounts arising out of more than one bet. The total of layoff bets, therefore, must have materially exceeded such total. [Italics supplied.]

Accordingly, on these bases, the Tax Court—in the absence of any adequate books or records kept and/or made available by the taxpayer, as pointed out, and because of the taxpayer's inability to estimate the proportions of his local bets to the out-of-town bets (R. 234), and reconciling and integrating the diverse and variegated elements involved—found, upon all the evidence, by means of painstaking estimate and approximation as best it could from the vague and meagre record before it, that the taxpayer received gross commissions from his activities as betting commissioner not in excess of $167,000, $145,000 and $108,000, aggregating $420,000, for the taxable years 1948-1950, respectively, and that the taxpayer had failed to establish any

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basis of the showing in the record that the total of such checks issued by him in net settlement of accounts with out-of-town bettors totaled $292,283.46 for the taxable year 1950. (R. 213.) The Tax Court concluded that since both of the parties in the Tax Court took the position, in effect, that such net settlement payments in unspecified amounts were also made under similar circumstances during the years 1948 and 1949, as in 1950, and they were satisfied that the same general pattern of such payments by check existed in 1948 and 1949—in each of which years deposits and undeposited checks exceeded those in 1950 (R. 240)—the amounts thereof for 1948 and 1949 were properly determinable on the basis of the 1950 payments of the same general pattern (R. 213, 233, 236, 237, 240).

lesser amounts for those years (R. 221, 234-237).[10] Hence, since the taxpayer had reported gross income from the operation of the Kingston Club in the sums of $56,795.13, $66,274.91 and $8,207.71 for those years, respectively, the Tax Court, subtracting the latter amounts from the gross commissions determined by it for each of those years, respectively, found the taxpayer's net understatements of taxable income in the total net sums of $110,204.87, $78,725.09 and $99,792.99 for the years 1948-1950, respectively. (R. 221, 235-237.[11] Moreover, while the Tax Court, like the Commissioner (R. 220), because of lack of substantiation and/or bases for calculating the amounts thereof, did not make any direct allowances or offsets for the taxpayer's pay-outs as such—though it surmised that the taxpayer as a betting commissioner "must have had substantial pay outs" (R. 230)—yet it did make allowances therefor in undisclosed amounts by indirection, notwithstanding the taxpayer's failure of proof, for each of the taxable years involved (R. 235, 236, 237). As the Tax Court put it in respect of the year

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[10] These amounts of gross income, after giving effect to additional allowances and deductions decreed by the Tax Court (R. 221-243), were revised and decreased by the Commissioner to the amounts of $134,904.93, $114,465.78 and $84,991.14 for the taxable years 1948-1950, respectively, as shown in the agreed computations for entry of decision under Tax Court Rule 50 as filed with the Tax Court on December 3, 1957 (R. 264).

[11] In this connection, the Tax Court stated (R. 237-238):

> The gross income and understatements determined by us with respect to petitioner's activities as betting commissioner for each of the years in question include any income or loss from the Kingston Club card room. [R. 209.] No separate income or loss from the [Kingston Club] card room operation has been reliably established.

See, also, fn. 8, *supra*.

1948 (R. 235), "To the extent that our approximation [of the taxpayer's gross commissions] approaches accuracy * * *, it necessarily gives indirect effect to the allowance of pay outs." (To the same effect, see also the Tax Court's similar statements in respect of the taxable years 1949 and 1950. (R. 236, 237.))

Under the foregoing circumstances, the Tax Court found upon the record as a whole as follows (R. 214, 226, 227, 235, 236, 237, 240-242, 243):

> We conclude with respect to 1948, that it is not likely that petitioner received gross commissions as betting commissioner in excess of $167,000 [R. 221], and that petitioner has failed to establish a lesser amount. From this, we subtract the gross income of $56,795.13 of the Kingston Club reported by petitioner in his income tax return [R. 220], and we find a net understatement of income as betting commissioner for 1948 in the amount of $110,204.87.
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> * * * * *
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> From all of the foregoing, we have concluded that it is not likely that petitioner received gross commissions in 1949 in excess of $145,000 [R. 221] and that petitioner has failed to establish a lesser amount. Subtracting gross income of $66,274.91 of the Kingston Club reported by petitioner in his income tax return [R. 220], we find a net understatement of income as betting commissioner for 1949 in the amount of $78,725.09. What we have said concerning other income and expenses and also, with respect to indirect allowance of pay outs for 1948, applies to 1949 as well.
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> * * * * *

As to 1950, we have concluded that it is not likely that petitioner received gross commissions in excess of $108,000 [R. 221] and that petitioner has failed to establish a lesser amount. Subtracting therefrom gross income from business in the amount of $8,207.71 reported by petitioner in his amended income tax return for 1950 [R. 220-221], we find a net understatement of income as betting commissioner for 1950 in the amount of $99,792.29. What we have said with respect to other income and expenses, and indirect allowance of pay outs for 1948 and 1949 applies also to 1950.

* * * * *

Keeping the above factors in mind, we think the record supports the inference (after due consideration of the variations in commissions which we have aready discussed) that petitioner received commissions from local bets in amounts not less than the following: 1948, $69,000; 1949, $60,000; 1950, $44,000.* * *

His [taxpayer's] method of doing business necessarily resulted in an excess of total receipts over total pay outs, and the volume of his business, inferable from the record, and the rate of commissions (allowing for the variations which we have already recognized), were such that his total commissions for each year involved greatly exceeded those reported.* * *

Upon the basis of these facts, the Tax Court found as ultimate facts (R. 221) that——

Petitioner's gross income from his activities as betting commissioner and the operation of the

Kingston Club card room for the respective years in question did not exceed the following: 1948-$167,000; 1949-$145,000; 1950-$108,000 [aggregating $420,000]. Thus, in view of the foregoing, it is clear, we submit, that the Tax Court's redeterminations and findings of the taxpayer's understatements of income for the taxable years involved have full support in the record.

Under the decisions, the foregoing findings of the Tax Court are entitled to finality where, as here, they are supported by substantial evidence and certainly are not shown by the taxpayer to be clearly erroneous. Rule 52(a) of the Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; *Joe Balestrieri & Co.* v. *Commissioner,* 177 F. 2d 867, 873 (C.A. 9th); *Grace Bros.* v. *Commissioner,* 173 F. 2d 170, 173-174 (C.A. 9th). "Here, the decision below was consistent with findings which on the evidence were well within the province of the trier" of the facts. *Chesbro* v. *Commissioner,* 225 F. 2d 674 (C.A. 2d), certiorari denied, 350 U.S. 995. Surely the Tax Court was not obliged to believe the taxpayer's self-serving testimony, whether or not contradicted or controverted, where it was patently untrue, incorrect and unconvincing, as here. (R. 238, 241-242, 246-247.) [12] *Quock Ting* v. *United States,* 140 U.S. 417; *Carmack* v. *Commissioner,* 183 F. 2d 1, 2 (C.A. 5th), certiorari denied, 340 U.S. 875; *Burka* v. *Commissioner,* 179 F. 2d 483, 485 (C.A. 4th);

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[12] In this connection, the Tax Court stated (R. 246) that——

> In the light of the foregoing, we, of course, reject petitioner's testimony to the effect that his returns were honest, correct and complete because analysis of the record demonstrates to the contrary.

Cohen v. *Commissioner,* 176 F. 2d 394, 399 (C.A. 10th). Neither was the Tax Court bound to accept the taxpayer's testimony "when there are facts which even indirectly may give rise to inferences contradicting the witness," as here. *Cohen* v. *Commissioner,* 148 F. 2d 336, 337 (C.A. 2d).

From the foregoing, it will be noted that, contrary to the taxpayer's contentions (Br. 49-51), there is ample support in the record for the Tax Court's redeterminations and findings of the taxpayer's gross understatements of income for each of the taxable years involved. The taxpayer contends nevertheless, substantially as in the Tax Court (R. 225-226), that the Tax Court, fully cognizant of the nature of his business as a betting commissioner handling large sums of money annually which necessarily required pay outs, erred in treating his deposits as gross income without allowing any deductions or eliminations therefrom for pay outs (Br. 37-41).[13] As against this, the Tax Court held that the taxpayer, having maintained and/or made available no records from which pay outs could be calculated or offered anything in substantiation thereof, and therefore confronted with inability to meet his burden of proof—which certainly did not thereby shift to the Commissioner—he was merely left with an unenforceable claim, a hardship of his own making, citing *Burnet* v. *Houston,* 283 U.S. 223. (R. 225-226.) In this connection, the Supreme Court stated in the *Burnet-Houston* case (p. 228) that——

> The impossibility of proving a material fact upon which the right to relief depends, simply leaves

[13] We have already shown that the Tax Court, by indirection, made allowances for pay outs in undisclosed amounts for each of the taxable years involved. (R. 235, 236, 237.)

> the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof.

See also *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 593; *Helvering* v. *Bruun,* 309 U.S. 461, 467-468; *Helvering* v. *Taylor,* 293 U.S. 507, 514-515; *Hague Estate* v. *Commissioner,* 132 F. 2d 775, 778 (C.A. 2d). Specifically in point, the Tax Court cited (R. 222-223) and relied on *Doll* v. *Glenn,* 231 F. 2d 186 (C.A. 6th) (1956) where the court, citing other analogous cases, said (p. 188):

> In the absence of the books and records of the Doll Lumber Company, the Commissioner was justified in treating the deposits in the bank account of H. A. Doll as gross income with the burden resting upon the taxpayer to show *what amounts, if any, were nontaxable income, and what deductions, if any, should be properly credited against it.** * * [Italics supplied.]

To the same effect, the Tax Court cited (R. 223) and relied on this Court's decisions in *Gobins* v. *Commissioner,* 217 F. 2d 952, affirming *per curiam* 18 T.C. 1159, 1168, and *Sterns* v. *Commissioner,* 235 F. 2d 584.

Nor did the Tax Court stop at this point but further showed not only that its findings of the taxpayer's understatements of income for the taxable years involved (R. 221, 229-238) are—contrary to the taxpayer's contentions here (Br. 48-51)—amply supported by the record, but also that he had received other income in cash which he did not report (R. 227, 238-243). As the Tax Court stated, while the Com-

missioner based his determination of the taxpayer's increases in his business income solely on deposits and undeposited checks cashed or endorsed over to others by him (plus the Film Row Club's gains, without offsetting losses), as already shown, yet it is clear from the record that the taxpayer had received substantial amounts in cash which he neither deposited nor reported and which the Commissioner did not include in his determination of the taxpayer's unreported business income. (R. 226-227, 238-243.) The Tax Court thereupon proceeded to demonstrate that—contrary to the taxpayer's contention (substantially as here (Br. 51-53)) that he, though engaged in an illegal business, was nevertheless an "honest" gambler and therefore his testimony that his tax returns as prepared by his Accountant Murton (and/or his assistants) should be accepted as filed, without a finding of any deficiencies (R. 238)—the taxpayer had, and was well aware of the fact that he had, realized substantial amounts of additional income from local cash bets in excess of his income reported, over and above that determined and included in his income by the Commissioner, for each of the taxable years in question (R. 238-243). In so doing, the Tax Court rejected the validity of the taxpayer's tax returns as prepared by his Accountant Murton because the latter's method of determining the income as reported thereon was faulty and erroneous. The reasons therefor were that Accountant Murton had completely disregarded and failed to take into consideration the taxpayer's undeposited cash in such returns on the theory that the "revolving fund" maintained by the taxpayer at approximately $3,000 was used by him in making pay outs to local winners, with any excess cash over and

above that amount purportedly deposited in the taxpayer's commercial bank account (R. 212), and therefore it was allegedly reflected in Accountant Murton's calculations in the tax returns as prepared by him and filed by the taxpayer (R. 212, 239). The record shows, however, that the taxpayer never furnished Accountant Murton any records of any of his cash transactions, cash bets placed, cash receipts, cash disbursements and/or cash commissions received as betting commissioner, and consequently Accountant Murton, in preparing the taxpayer's returns for the taxable years in question, never took into consideration any of the taxpayer's undeposited cash. (R. 212, 239.) The Tax Court found, moreover, that despite the fact that the taxpayer's local bets were largely settled in cash, only a small portion of such cash ever found its way into the taxpayer's commercial bank account as shown by the fact that out of total deposits of $1,195,632.72 therein, averaging $398,544.26 annually for the three taxable years involved (R. 212-213), cash only in the amounts of $430, $8,470 and $13,955, aggregating $22,895, had been deposited therein during those years, respectively (R. 212, 241).

In these circumstances, the Tax Court, stating that though there is no specific evidence in the record as to the amounts of local bets placed by the taxpayer, yet "a conservative estimate [thereof] may be inferred from correlation with the amount of bets laid off with out-of-town betting commissioners", and just as the evidence in respect of the out-of-town bets furnished the Tax Court a basis for an estimate or approximation of the total out-of-town bets (R. 231-237), as already shown, so, as a corollary, the same evidence furnished a basis for an estimate and approximation

of the taxpayer's local cash bets (R. 239-240 [14]). Accordingly, the Tax Court concluded upon all the evidence that the record supports the inference that the taxpayer received commissions from local cash bets in amounts not less than $69,000, $60,000 and $44,000, aggregating $173,000, for the three taxable years 1948-1950, respectively (R. 240-241), and thereupon found (R. 241) that—

> We think it apparent upon consideration of all of the circumstances that large amounts of cash commissions in each of the years in question were not deposited in the bank and could not have been reflected in [Accountant] Murton's figures which disregarded cash or in petitioner's income tax returns [as filed for those years] based on Murton's data.

Moreover, the Tax Court, rejecting the taxpayer's contention that all cash receipts (including cash commissions) were used for pay outs (R. 241), further found (R. 241-242) that——

> His [taxpayer's] method of doing business necessarily resulted in an excess of total receipts over total pay outs, and the volume of his business, inferable from the record, and the rate of commissions (allowing for the variations which we have already recognized) were such that his total commissions for each year involved greatly exceeded those reported. Since the total commissions were obviously not reflected in his commercial bank

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[14] In this connection, the Tax Court stated (R. 240) that——

> We think the foregoing furnishes a basis for an estimate or approximation of total out-of-town bets. As a corollary, it furnishes a basis for approximating local bets. * * *

account, the inference is clear that they were received and retained in cash. * * *

The foregoing, we submit, further tends to show that the record fully supports the Tax Court's redetermination of the taxpayer's understatements of income totaling $420,000 for the taxable years in question. (R. 221, 235-237.)

By virtue of the unusual circumstances of this case, the Tax Court, cognizant of the fact that the burden of proof was on the taxpayer to show the Commissioner's determination wrong and to establish *all* the elements upon which his right to deductions was based under the rule of *Helvering* v. *Taylor,* 293 U.S. 507, 515, and *Burnet* v. *Houston,* 283 U.S. 223 (R. 224-225), nevertheless realized the impossibility of accurate determination of the taxpayer's tax liability upon this record because of his failure to have kept essential records showing income. Hence, the Tax Court considered it its duty, not merely to sustain the Commissioner's determination harshly and unrealistically but, rather, to approach the problem indirectly by analysis of the record in the light of the best-estimate rule of *Cohan* v. *Commissioner,* 39 F. 2d 540 (C.A. 2d). In so doing, the Tax Court resolved any reasonable doubts against the taxpayer, and reconstructed his gross income at a figure which, in its judgment, his income would be unlikely to have exceeded *in fact*—the taxpayer having failed to establish any lesser amount. (R. 230.) In support of its action, the Tax Court relied on this Court's decision in *Roberts* v. *Commissioner,* 176 F. 2d 221, 226, from which it quoted and stated as follows (R. 231):

The petitioner had kept no books. So the Tax Court had to determine the amount from such evi-

dence as was presented to them. *If the result is an approximation, the lack of exactitude is traceable to the petitioner's own failure to keep accurate account.* As said by the Court of Appeals for the Second Circuit:

> "Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making." *Cohan* v. *Commission,* 1930, 39 F. 2d 540, 543, 544. * * * [Emphasis supplied.]

In the instant case, we make no pretense at precision. We merely do our best to circumscribe the results within practical limits by the exercise of our judgment within the scope of the principles announced in *Roberts, supra,* and *Cohan, supra.*

It is clear that the Tax Court, in so doing, did *all* it possibly could in order to avoid being harsh and unrealistic under the meagre, inadequate facts of this case, nor did the taxpayer meet his requisite burden of showing that the Commissioner's determination, as redetermined by the Tax Court, was arbitrary and/or invalid. *Helvering* v. *Taylor, supra; Burnet* v. *Houston, supra; Viles* v. *Commissioner,* 233 F. 2d 376, 379 (C.A. 6th). In these circumstances, the Tax Court, in view of the taxpayer's disingenuous tactics resorted to in giving untrue and incredible testimony (see fn. 12, *supra*), would have been justified in applying a severe measure. The taxpayer cannot complain of the Tax Court's estimates and approximations when, as here, the findings are based on the best evidence available

and the taxpayer chose not to help.[15] *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th), citing *Cohan* v. *Commissioner,* 39 F. 2d 540 (C.A. 2d). In this connection, the Tax Court cited (R. 227-228) *Greenwood* v. *Commissioner,* 134 F. 2d 915, where this Court stated as follows (pp. 919, 922):

> "Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid." (*Helvering* v. *Taylor,* 1935, 293 U.S. 507, 515 * * *), which burden is sustained by a clear showing that the determination was arbitrary or erroneous. * * *
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> * * * * *
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> Petitioner has failed to overcome the presumption of validity attaching to the determination of the Commissioner, * * *

To the same effect, *American Pipe & Steel Corp.* v. *Commissioner,* 243 F. 2d 125, 126-127 (C.A. 9th), also cited by the Tax Court (R. 228); see also *Viles* v. *Commissioner,* 233 F. 2d 376, 379 (C.A. 6th), citing *Helvering* v. *Taylor,* 293 U.S. 507.

In view of the foregoing, we believe that a detailed discussion of the numerous items of income, etc., complained of variously by the taxpayer (Br. 32-53), which were given full consideration and effect by the Com-

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[15] As already pointed out, the taxpayer's counsel not only refused to give the Commissioner's revenue agent the benefit of the use of the taxpayer's records—which counsel concededly had in his possession (R. 218-219)—during his investigation of the taxpayer's income tax returns (R. 188-189, 196, 197, 204-205, 219, 227), but also the taxpayer's testimony was so incorrect and untrue that the Tax Court was obliged to reject as being incorrect and untrue (R. 246). See fn. 12, *supra.*

missioner in his determination (R. 7-12), and by the Tax Court in its findings and redetermination (R. 207-243), is unnecessary. It is sufficient to observe that the Tax Court's findings of fact dispose of the taxpayer's contentions as to the various disputed items; that such findings are all supported by substantial evidence, including the testimony of the taxpayer's own witnesses, and that the Tax Court's findings, so supported, are conclusive upon review. *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U.S. 37; *Phillips* v. *Commissioner,* 283 U.S. 589; *Burnet* v. *Leininger,* 285 U.S. 136. Even if it were true that the unreported income of the taxpayer was not determined with absolute precision, a fact which the Tax Court explained in full detail as warranted by the decisions of this Court and other Courts of Appeals (R. 230-231), the difficulty is apparently due in large part to the taxpayer's failure, indeed refusal, to have introduced his own records from which it could undoubtedly have been much more accurately determined. In such circumstances, approximation in the calculation of net income is justified. *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th); *Cohan* v. *Commissioner,* 39 F. 2d 540, 543, 544 (C.A. 2d); *Harris* v. *Commissioner,* 174 F. 2d 70 (C.A. 4th); *Halle* v. *Commissioner* 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; compare *Helvering* v. *Safe Deposit Co.,* 316 U.S. 56, 66-67.

The taxpayer's fundamental objection to the results arrived at by the Tax Court is that the Tax Court allegedly erred in holding that he had failed to show that the Commissioner's determination of deficiencies was arbitrary and invalid, and that the burden was on the taxpayer to establish that he did not owe the amounts determined by the Commissioner in the deficiency

notice. (Br. 26-41.) For this contention, likewise advanced in the Tax Court (R. 224), the taxpayer relies heavily on *Helvering* v. *Taylor,* 293 U.S. 507 (Br. 27-28). We have already shown that this contention is wholly without merit as being without support in the record, nor does the taxpayer show anything to the contrary here leading to a different result. Moreover, the taxpayer's reliance on *Taylor* and similar cases (Br. 27-28) is manifestly misplaced. In the *Taylor* case the Government contended that even where the taxpayer has shown that the Commissioner's determination was arbitrary and excessive, he must prove the correct amount of the tax in order to succeed. The Supreme Court held to the contrary, for otherwise the Commissioner's determination would stand. We make no such contention here, nor did the Tax Court so hold. The taxpayer here has not shown that the Commissioner's determination—to the extent redetermined by the Tax Court—was arbitrary or that it was excessive. (R. 224-225.) The *Taylor* case holding that a case may be remanded to permit the taxpayer to introduce further evidence in nowise detracts from the familiar rule that the taxpayer is required "to show not only that the Commissioner is wrong but also to produce evidence from which a proper determination may be made." 9 Mertens, Law of Federal Income Taxation, p. 286. The taxpayer here was afforded full opportunity to meet the burden of proving the Commissioner's determination to be wrong, if it was, and to the extent that the taxpayer proved it to be wrong the Tax Court overruled the Commissioner—indeed, even more so by allowing the taxpayer's unproved losses to the extent of gains, for example (R. 229)—and reduced the asserted deficiencies accordingly. The taxpayer had every op-

portunity to prove his case and to remedy the deficiencies in his proof. The taxpayer, however, declined to take advantage thereof to prove his case, even to the extent of failing to introduce his own records in evidence. (R. 227.) See fn. 15, *supra*. In these circumstances, it is clear that, upon this record, the Commissioner's determination as redetermined by the Tax Court upon the record as a whole should be given effect.

Finally, we submit that the failure of the taxpayer to have furnished his records to the Commissioner's revenue agent during the investigation of his tax returns for the taxable years involved and/or to the Tax Court during the hearing of his case carries with it the clear implication that such documents, if offered, would have been detrimental to his case. Cf. *Interstate Circuit* v. *United States,* 306 U.S. 208, 226; *Cohen* v. *Commissioner,* 9 T.C. 1156, 1163-1164, affirmed, 176 F. 2d 394, 397, 399 (C.A. 10th); *Wichita Term. El. Co.* v. *Commissioner,* 6 T.C. 1158, 1165, affirmed, 162 F. 2d 513 (C.A. 10th). It is a settled rule in both civil and criminal cases that if a party has it within his power to produce evidence which would elucidate the matter in dispute, the fact that he refrains from doing so creates a presumption that the evidence, if produced, would have been unfavorable. *Interstate Circuit* v. *United States,* 306 U.S. 208, 226; *Mammoth Oil Co.* v. *United States,* 275 U.S. 13, 52; *Kirby* v. *Tallmadge,* 160 U.S. 379, 383; *Graves* v. *United States,* 150 U.S. 118, 121; *Cohen* v. *Commissioner,* 176 F. 2d 394, 399 (C.A. 10th). Moreover, if the taxpayer may deliberately fail to keep and make available books and records clearly showing his true income—though required by law to do so (Section 54(a) of the 1939 Code; Section 29.54-1 of Treasury Regulations 111, both Appendix, *infra*)—and to

withhold his records from the Commissioner's investigating revenue agents, the Tax Court and now this Court with immunity, lest he incriminate himself, as here (R. 173-175, 176-177, 188-190, 204-205, 226, 227, 246-247), he can thereby defeat the effectiveness of the income tax laws so far as he is concerned. The taxpayer has thus far succeeded in so doing here, and now, trapped by the fraud of his own making (dealt with under Point II, *infra*), he has the temerity to implore this Court for relief, taxwise, from his dilemma. Upon the basis of prior decisions of this Court—too numerous to warrant mentioning—we submit that such relief should be denied him forthwith.

II

The Tax Court Correctly Found upon the Entire Record that a Part of the Deficiencies in Taxes Was Due to Fraud with Intent to Evade Taxes for Each of the Three Taxable Years 1948-1950, and Therefore He Is Liable for the 50 Per Cent Fraud Penalties as Redetermined by the Tax Court for Those Years, Under the Pertinent Provisions of the Taxing Statutes

The question presented here is whether the record supports the Tax Court's findings made upon all the evidence, that the taxpayer is liable for the 50 per cent fraud penalties imposed by the taxing statute (Section 293(b) of the Internal Revenue Code of 1939, Appendix, infra) as statutory additions to his income taxes, as determined and asserted against him by the Commissioner—to the extent redetermined by the Tax Court—for the taxable years 1948-1950. The Tax Court found that the taxpayer was guilty of fraud for each of those years and therefore he is liable for the fraud penalties as asserted for such years. (R. 243-248.) The taxpayer contends that this is error. (Br. 53-62.)

Section 293(b) of the Internal Revenue Code of 1939 provides that "If any part of any deficiency is due to fraud with intent to evade tax," then 50 per cent of the deficiency shall be added thereto. It has been held that these plain words leave no room for construction. *Mauch* v. *Commissioner,* 113 F. 2d 555 (C.A. 3d). On this point, the Tax Court found, upon all the evidence, as ultimate facts that a part of the deficiency asserted for each of the three taxable years involved was due to fraud with intent to evade taxes within the meaning of Section 293(b) (R. 221), and thereupon sustained in large part the determination of the Commissioner —who had carried his burden of proof in this respect (Section 7454 of the 1954 Code, Appendix, *infra*) (R. 243-248).

It is settled that whether an understatement of or failure to report income is due to fraud presents solely a question of fact, and that the Tax Court's determination in respect thereto is final if supported by substantial evidence and is not shown to be clearly erroneous, as here. *Carmack* v. *Commissioner*, 183 F. 2d 1 (C.A. 5th), certiorari denied, 340 U.S. 875; *Helvering* v. *Kehoe*, 309 U.S. 277, 279; *Sterns* v. *Commissioner*, 235 F. 2d 584 (C.A. 9th); *Gobins* v. *Commissioner,* 217 F. 2d 952 (C.A. 9th); *Rose* v. *Commissioner,* 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Davis* v. *Commissioner,* 239 F. 2d 187 (C.A. 7th); *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th); *Halle* v. *Commissioner*, 175 F. 2d 500, 503-504 (C.A. 2d), certiorari denied, 338 U.S. 949; *United States* v. *Gypsum Co.*, 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; Rule 52(a), Federal Rules of Civil Procedure. As the court stated in *Na-*

tional City Bank of New York v. *Helvering*, 98 F. 2d 93, 96 (C.A. 2d):

> Although fraud must be well proved, the taxpayer has the burden of showing that the Commissioner was wrong and that the Board had no basis for its finding.

While "Fraud cannot be lightly inferred, but must be established by clear and convincing proof" (*Rogers* v. *Commissioner*, 111 F. 2d 987, 989 (C.A. 6th); *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th)), yet the obligation of the Commissiner to prove it relates only to the fraud penalty and not the correctness of the deficiency (*Cohen* v. *Commissioner*, 9 T.C. 1156, affirmed, 176 F. 2d 394 (C.A. 10th); *United States* v. *Chapman*, 168 F. 2d 997 (C.A. 7th)). Moreover, "there is no burden upon the Government to prove its case beyond a reasonable doubt." *Helvering* v. *Mitchell*, 303 U.S. 391, 403; *Spies* v. *United States*, 317 U.S. 492, 495.

Dispositive of the taxpayer's contentions that he was not guilty of fraud with intent to evade the payment of income taxes for the three taxable years involved (Br. 53-62) are the Tax Court's findings made upon all the evidence and not shown by the taxpayer to be clearly erroneous. Thus, the Tax Court found that the taxpayer had understated and failed to report taxable income in large amounts for all three taxable years involved. (R. 235, 236, 237, 244-248.) Specifically, the Tax Court found upon the evidence that the taxpayer had understated and failed to report taxable income in the total amounts of $110,204.87, $78,725.09 and $99,-792.29, aggregating $288,722.25, for the taxable years 1948-1950, respectively, over and above the total amount of $131,277.75—an annual average of only $43,759.25—

reported by him for those years, or an average understatement of income of more than $96,000 for each of the three successive years involved. (R. 220-221, 235, 236, 237.) This, quite clearly, is one of the most significant facts showing an intent to defraud, that is, the taxpayer's consistent, *continuing* failure to report substantial amounts of taxable income from year to year over the three-year taxable period involved. Paraphrasing the words of the Second Circuit in *Halle* v. *Commissioner,* 175 F.2d 500, 503, certiorari denied, 338 U.S. 949, a fraud case comparable in flagrancy, "The deficiencies here were too many, too varied, too continuous and too excessive to be plausibly attributed to inadvertence or carelessness * * * [and] were such in magnitude and importance that they could hardly have been overlooked by a prosperous * * * [businessman such as the taxpayer here]; and all the facts, set in their proper background, simply cry out against any such inference". As the Sixth Circuit said in this connection in *Rogers* v. *Commissioner*, 111 F. 2d 987, 989:

> It is conceivable that taxpayers may make minor errors in their tax returns, or, owing to different or contradictory theories of tax computation, calculate returns which differ greatly in result from the Commissioner's assessments. Here petitioners do not have that excuse. Discrepancies of 100 per cent and more between the real net income and the reported income for three successive years strongly evidence an intent to defraud the Government. The Board did not err in deciding that 50 per cent penalties should be assessed.

See also *Wood* v. *United States*, 16 Pet. 342, 360-361, holding that "fraudulent intent" or motive for a par-

ticular act may always be shown by "evidence of other acts and doings of the party, of a kindred character"; and see *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th); *Davis* v. *Commissioner*, 239 F. 2d 187 (C.A. 7th); *Rogers* v. *Commissioner*, 111 F. 2d 987, 989 (C.A. 6th).

On the record as a whole, the Tax Court concluded (R. 244-247) that—

> After a painstaking analysis of all of the evidence in this case, and bearing in mind the above-stated principles, we are convinced that petitioner received taxable income during each of the years 1948, 1949 and 1950 from his activities as betting commissioner in excess of that reported on his returns for those years, and that in each of said years a part of the deficiency was due to fraud with intent to evade taxes. * * *
> * * * we reach the conclusion that there was a substantial understatement of income on petitioner's return for each of the taxable years in question.
> * * * after resolving any doubts in this respect against respondent, with whom the burden of proof of fraud lies, we hold, upon our analysis of the record, that the understatements were substantial for each year before us. Our analysis likewise convinces us that a large part of the understatements in each of said years was attributable to petitioner's failure to include in his return the receipt of commissions in cash.
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> * * * * *
>
> Here, in addition, petitioner failed to maintain records of his cash transactions, or of the cash commissions earned in such transactions, and kept uninformed the accountants whom he em-

> ployed to prepare the data for his returns and the returns themselves. Petitioner admits that his failure to maintain records of his transactions as betting commissioner was deliberate. The reason he assigns was to keep them from law enforcement officers on the lookout for illegal gambling activities. We have no doubt that [the taxpayer's] concealment from the tax authorities and evasion of taxes was a coordinate objective. * * * Petitioner was an educated man and could not have been unaware of his obligations as a taxpayer. * * *
>
> We think it clear, without going into further detail, that fraudulent intent to evade taxes must be inferred from petitioner's conduct as disclosed by the record.

Accordingly, the Tax Court thereupon found as ultimate facts (R. 221) that—

> Petitioner, in his income tax returns for each of the years in question, substantially understated income from his activities as betting commissioner and the operation of the Kingston Club card room. A part of the deficiency for each of the years involved was due to fraud on the part of petitioner with intent to evade taxes within the meaning of section 293(b) [of the Internal Revenue Code of 1939].

These findings, not shown by the taxpayer to be in anywise erroneous (Br. 53-62), are likewise entitled to finality under the same decisions already cited in this connection under Point I, *supra*. Moreover, the Tax Court, in so finding, was not unmindful of the requirements of the statute (Section 7454 of the Internal

Revenue Code of 1954, Appendix, *infra*) which places on the Commissioner the burden of establishing fraud, and, as pointed out, it found that the Commissioner had sustained this burden. (R. 248.) Indeed, the careful and discriminating opinion of the Tax Court (R. 243-248) shows clearly that it knew the applicable legal standards and knew how to apply them.

The taxpayer, in denying fraud (Br. 53-62), has overlooked or ignored certain specific requirements which all taxpayers are legally bound to abide by under controlling rules long since laid down by the Supreme Court in cases such as this. Thus, the Court stated in *Helvering* v. *Mitchell,* 303 U.S. 391, 399, that "In assessing income taxes the Government relies primarily upon the *disclosure by the taxpayer* of the relevant facts" in his tax returns, and "To ensure full and honest disclosure, to *discourage fraudulent attempts to evade the tax,* Congress imposes sanctions." [Italics supplied.] And in *Spies* v. *United States,* 317 U.S. 492, 495, 496, the Supreme Court also said that the "taxpayer's neglect or deceit may prejudice the orderly and punctual administration of the [Government's tax collections] system as well as the revenues themselves," in anticipation of which "Congress had imposed a variety of sanctions for the protection of the system and the revenues" lawfully due the Government; and *Hence the willful failure to * * * supply information when required,* is made a misdemeanor, without regard to existence of a tax liability." [Italics supplied.] Likewise, the courts have held in respect of the Government's tax collection system that "Its efficiency must depend largely on the *truth of facts* set out by the taxpayer in his return." [Italics supplied.] *Halle* v. *Commissioner,* 175 F. 2d 500, 502 (C.A. 2d), certiorari

denied, 338 U.S. 949. See also *Holland* v. *United States*, 348, U.S. 121, 132, rehearing denied, 348 U.S. 932.

As the court stated in *Davis* v. *Commissioner*, 239 F. 2d 187, 188 (C.A. 7th), "consistent, substantial understatement of income is highly persuasive evidence of intent to defraud." See also *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th). Many cases have held that a taxpayer's failure to report substantial amounts of net income on his income tax return consistently from year to year is in itself convincing evidence of fraud. *Gobins* v. *Commissioner*, 217 F. 2d 952 (C.A. 9th); *Sterns* v. *Commissioner*, 235 F. 2d 584 (C.A. 9th); *Rose* v. *Commissioner*, 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Humphreys* v. *Commissioner*, 125 F. 2d 340 (C.A. 7th), certiorari denied, 317 U.S. 637; *Rogers* v. *Commissioner*, 111 F. 2d 987, 989 (C.A. 6th); *Hoefle* v. *Commissioner*, 114 F. 2d 713 (C.A. 6th); *Battjes* v. *United States*, 172 F. 2d 1, 5 (C.A. 6th); *Halle* v. *Commissioner*, 175 F. 2d 500, 504 (C.A. 2d), certiorari denied, 338 U.S. 949; *Heyman* v. *Commissioner*, 176 F. 2d 389, 393-394 (C.A. 2d), certiorari denied, 338 U.S. 904; *Mitchell* v. *Commissioner*, 89 F. 2d 873 (C.A. 2d), reversed on other grounds, 303 U.S. 391 [16]; *Schwarzkopf* v. *Commissioner*, 246 F. 2d 731 (C.A. 3d); *Mauch* v. *Commissioner*, 113 F. 2d 555, 557 (C.A. 3d); *Harris* v. *Commissioner*, 174 F. 2d 70 (C.A. 4th); *Stinnett* v. *United States*, 173 F. 2d 129 (C.A. 4th), certiorari

[16] In the *Mitchell* case the Second Circuit held that there was ample evidence to sustain the finding of the Board of Tax Appeals (now the Tax Court) that there was fraud with intent to evade the tax, but that Mitchell's prior acquittal on the charge of violation of a criminal statute relating to fraudulent evasions of income taxes prevented the imposition of the 50% fraud penalty. The Supreme Court reversed on that issue.

denied, 337 U.S. 957; *Schuermann* v. *United States*, 174 F. 2d 397, 399 (C.A. 8th), certiorari denied, 338 U.S. 831, rehearing denied, 338 U.S. 881; *Cooper* v. *United States*, 9 F. 2d 216, 222 (C.A. 8th). See also *National City Bank of New York* v. *Helvering*, 98 F. 2d 93 (C.A. 2d), where the court held (p. 96) that the evidence, that the corporate officer there accepted the bonds as an illicit bonus or commission on the contract negotiated by him and treated them as his own during the particular years involved, was sufficient to authorize penalizing him for fraud for having omitted the bonds from his income tax returns for those years. Moreover, it was long ago aptly stated in *Commissioner* v. *Dyer,* 74 F. 2d 685, 686 (C.A. 2d), certiorari denied, 296 U.S. 586, that "Could any doubt exist, it is laid to rest by the repetition of the ritual in the second year." Here there was repetition by the taxpayer in the second and third years.

As to the taxpayer's contention here (Br. 53-54), as in the Tax Court, that the Commissioner allegedly failed to meet his burden of proving intent to defraud, we submit that the taxpayer here "may be presumed to intend the necessary and natural consequences of his acts," as the Eighth Circuit held in *Myres* v. *United States*, 174 F. 2d 329, 344, certiorari denied, 338 U.S. 849. As the Tax Court said (R. 244):

> We also recognize that in this, as in many fraud cases, the proof of fraud, if it is to be established, must depend in some respects upon circumstantial evidence. Fraudulent intent can seldom be established by a single act or by direct proof of the taxpayer's intention. It is usually found by surveying his whole course of conduct and is to be ad-

duced as any other fact from all the evidence of record and inferences properly to be drawn therefrom. *M. Rea Gano,* 19 B.T.A. 518 (1930).

Moreover, as already shown, a consideration of all the evidence affords clear and convincing proof that the taxpayer knowingly and "consistently cheated the Treasury" in evading his income taxes for all three taxable years involved. *Seifert* v. *Commissioner*, 157 F. 2d 719 (C.A. 2d). As stated by the court in *Heyman* v. *Commissioner*, 176 F. 2d 389, 394 (C.A. 2d), certiorari denied, 338 U.S. 904, "We think the situation as a whole was shown to have been instinct with fraud and that the finding of the Tax Court, far from being erroneous, was plainly right." It follows, we submit, that the Commissioner's determination and the Tax Court's finding of fraud with intent to evade taxes must be accepted as correct.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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SEPTEMBER, 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The

amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U.S.C. 1952 ed., Sec. 54.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

(26 U.S.C. 1952 ed., Sec. 276.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum

of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

(26 U.S.C. 1952 ed., Sec. 293.)

Internal Revenue Code of 1954:

SEC. 7454. BURDEN OF PROOF IN FRAUD AND TRANSFEREE CASES.

(a) *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate.

* * * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 7454.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-1. *What Included in Gross Income.* —Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. * * *

* * * * *

Sec. 29.41-1. *Computation of Net Income.*— * * * If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41-3. *Methods of Accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. * * *

* * * * *

Sec. 29.54-1. *Records and Income Tax Forms.*—Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Such books or records shall be kept at all times available for inspection by internal-revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal-revenue law.

* * * * *

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No. 15,982

United States Court of Appeals

For the Ninth Circuit

LESLY COHEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S REPLY BRIEF.

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Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S REPLY BRIEF.

PRELIMINARY STATEMENT.

The brief for the Respondent was received on September 11, 1958. By order of this Court Petitioner was given until September 29, 1958, to file a reply to the Respondent's brief. For convenience and clarity the Petitioner's reply will follow the numbering in Respondent's brief. References to the Transcript of Record are abbreviated (R), references to the Respondent's brief (R-Br) and to Petitioner's brief (P-Br).

In the first forty-three pages of his brief, Respondent cites an extraordinary number of cases with which Petitioner has no quarrel to establish legal principles

which are not in dispute. In the last paragraph on page 43 of his brief, Respondent finally reaches the issue before this Court, "The taxpayer's fundamental objection to the results arrived at by the Tax Court is that the Tax Court allegedly erred in holding that he had failed to show that the Commissioner's determination of deficiencies was arbitrary and invalid, and that the burden was on the taxpayer to establish that he did not owe the amounts determined by the Commissioner in the deficiency notice." It is most significant that nowhere in his brief does Respondent claim that the *original determination* was *not* arbitrary and excessive. Indeed, his failure to do so tacitly admits that the original determination was arbitrary as demonstrated in Petitioner's Opening Brief.

Respondent's position is stated on page 44 of his brief as follows: "The taxpayer here has not shown that the Commissioner's determination—*to the extent redetermined by the Tax Court*—was arbitrary or that it was excessive". (Emphasis added.) And on page 41, "nor did the taxpayer meet his requisite burden of showing that the Commissioner's determination, as redetermined by the Tax Court, was arbitrary and/or invalid". These statements show a complete misconception of the law as laid down by the Supreme Court in *Helvering v. Taylor,* 1935, 293 U.S. 507, 515. The question is not whether the determination was arbitrary or excessive *after* the Tax Court trimmed off four-fifths of it, but whether it was arbitrary and excessive as *originally determined.* Under the rule of *Helvering v. Taylor,* supra, if the original determina-

tion by the Commissioner was arbitrary and excessive the burden of proof shifted to the Respondent and it is obvious from both the Tax Court opinion and the Respondent's brief that the Tax Court judgment cannot be sustained if the burden of proof were not on the Petitioner. Apparently Respondent's theory is that the determination was not arbitrary as to that portion which the Tax Court sustained. This point might be valid where the Tax Court had sufficient evidence before it, whether produced by the Respondent or the taxpayer to prove the *exact tax liability* of the taxpayer. However, it can have no possible validity in a case like this one where the Tax Court's determination itself is admittedly based upon its finding that the burden of proof was on the taxpayer to show that he did not owe the amounts determined. The Respondent is saying, in effect, that the burden of proof is on the taxpayer because the Tax Court found deficiencies against the taxpayer because the burden of proof was on the taxpayer, an unsatisfactory attempt to lift one's self by one's bootstraps.

The presumption in favor of the Commissioner's determination has been sustained by the Courts as a necessary aid to the collection of taxes. Obviously it is a power which is susceptible to great abuse. In the hands of a tyrannical bureaucracy it could undermine our most cherished liberties. Therefore, the Supreme Court wisely restricted its use. If the Commissioner uses this great power arbitrarily, he loses the advantage of the presumption, even as to a part of the assessment that he might otherwise have collected. If

he is left with an unprovable claim, it is a hardship of his own making. The quotation from *Burnet v. Houston,* 283 U.S. 223 (R-Br 35-36), is just as applicable to Respondent, where he has forfeited his presumption, as it is to a taxpayer,

> "The impossibility of proving a material fact upon which the right to relief depends, simply leaves the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof."

Since the original determination of the Respondent was arbitrary and excessive, the presumption in favor of its validity was lost and since the Tax Court admittedly based its judgment upon the theory that the burden of proof was on the taxpayer to prove that he did not owe the amounts found by the Tax Court, it is clear that the judgment of the Tax Court cannot be sustained.

A.

Respondent's thesis, as stated in Section A of his brief, is stated as follows (R-Br 19): "The Tax Court did not err in sustaining the Commissioner's determination of the taxpayer's unreported taxable net income and the resulting deficiencies—to the extent redetermined by it—for the three taxable years involved by the use of the bank deposit method."

It should be noted that Respondent's statement that the Tax Court did not err in finding that the Commissioner's determination, *to the extent redetermined by it,* was neither arbitrary nor invalid, fails to state

that the original determination was not arbitrary. We have dealt with this matter more fully in the preceding portion of this brief.

Respondent's reference to the bank deposit method is confusing and misleading because it indicates that both the Commissioner and the Tax Court used the so-called bank deposit method. There is no similarity between the method used by the Commissioner in making his original determination and the method used by the Tax Court in arriving at the deficiencies determined by it. The Tax Court said, "We think our only proper course is to approach the problem indirectly by analysis of the record in the light of the principles established in Cohen v. Commissioner." (R. 230.) There can be no question that the bank deposit method does not clearly reflect income of a betting commissioner whose income is wholly derived from commissions. The Tax Court recognized this fact and made no attempt to sustain the Commissioner's determination under the bank deposit method. The Tax Court's discussion of the bank deposit method was directed to the question of whether or not the Commissioner's original determination had been arbitrary. The Court found that the Respondent's determination was wrong and resulted in deficiencies more than five times what the Tax Court thought represented the highest possible liability. The Tax Court's principal concern with the bank deposit method was to save the presumption in favor of the Commissioner's determination because its own findings under the Cohen rule could only be sustained

with the aid of that presumption. Otherwise the Tax Court considered the bank deposits as one of the factors indicating Petitioner's gross volume of bets.

The Commissioner himself did not follow the bank deposit method as that method is described in Respondent's brief (R-Br 21): "It has long been settled, by this Court and by other courts of appeal, that, under circumstances such as those here involved, the Commissioner, having no alternative, is at liberty to determine taxable income from third party records and other sources in order to establish, as accurately as possible, the true income, and therefore is warranted in treating as taxable income any unexplained excess of bank deposits over non-taxable and reported income."

Petitioner had reported gross income for the years involved in the amount of $131,277.75. Under the rule above stated, only the *excess* of the bank deposits over the reported income should have been set up as additional income. This is just one of the many circumstances that indicate that the Respondent was not interested in trying to establish "as accurately as possible the true income" but was intent on making a fantastically large determination, which would catch the newspaper headlines and show that the Bureau of Internal Revenue was striking hard at nationwide gambling.

Respondent cites numerous cases in which the Commissioner's right to determine taxable income from third party records and unexplained bank deposits was sustained. Petitioner has no quarrel with the cases

cited. Respondent cites no case, and we know of none, which holds that the Commissioner is permitted to make an unreasonable and arbitrary determination of deficiencies, whether based upon the bank deposit method, third party records, or any other method. The correct rule is stated in the case of *Schira v. Commissioner,* 240 Fed. 2d 672, 50 AFTR 1404, as follows:

> "In the absence of books and records the Commissioner was justified in making assessments based upon other available evidence, *provided they were not arbitrary or unreasonable.*" (Emphasis added.)

Petitioner's complaint here is not that Respondent used third party records and other sources, but rather that he deliberately disregarded available information and made a determination which he must have known did not "clearly reflect income".

B.

The Respondent's thesis under B of his brief is stated as follows: "The amounts of the taxpayer's understatements of unreported income and the resulting deficiencies were properly computed by the Commissioner—to the extent redetermined by the Tax Court—for each of the three taxable years involved."

As a corollary to this statement it would seem to follow that to the extent Respondent's proposed deficiencies were *not* sustained by the Tax Court, they were improperly computed by the Commissioner. In this, as in the other sections of his brief, hereinbefore referred to, Respondent studiously refrains from

claiming that the Commissioner's determination was not arbitrary before it was redetermined by the Tax Court.

After outlining the process which Adrian claimed that he used in computing Petitioner's income, Respondent concludes (Br 27): "In view of the foregoing, it cannot properly be said that the Commissioner's Revenue Agent, in the absence of any books or records kept and/or made available by the taxpayer, did anything other than what was necessary in order to compute the taxpayer's taxable income by the bank deposit method". We emphatically disagree. The record shows that Adrian did not make a bona fide effort to ascertain Petitioner's true income by the bank deposit method or by any other method. He was simply looking for names and information which could be used in the nationwide crack-down on gambling. He obtained most of his information from other Revenue Agents engaged in the same crack-down all over the country and naturally he wished to reciprocate. Special Agent Lund's attempt to see the books was concerned with an investigation of a different taxpayer. When Petitioner refused to make his records available at that particular time, the Respondent "threw the book at him". Adrian appeared to believe that all he had to do was "determine" a figure, regardless of how untenable and unfounded it might be, and the Commissioner's presumption would cure all defects. Adrain overlooked, and the Respondent here overlooks, that the determination must "in the opinion of the Commissioner clearly reflect income" and may

not be arbitrary. From the information available to him, Adrian could not reasonably have believed that his determination clearly reflected income. Let us recapitulate briefly the facts which show that the original determination was an arbitrary, politically-motivated determination, which Respondent knew did not clearly reflect income.

First, Adrian determined that all of the bank deposits constituted income, not merely the *excess* over non-taxable and unreported income. Thus, his determination was more than $131,000.00 too high under the authorities set for on page 21 of Respondent's brief.

Second, although he knew that Petitioner was a betting commissioner (R 200) and that his gross income would be but a small percentage of his gross receipts, he deliberately included all known gross receipts in income. If Petitioner's net commissions averaged 2½%, as seems reasonable under the Tax Court's findings, Petitioner's reported income for the three years involved would have required gross receipts of $5,251,110.00. On the same basis, in order to have secured income in the sum of $1,561,763.35, as "determined" by the Respondent, would have required gross receipts in excess of $39,000,000.00. Even if Petitioner had realized 5% on every transaction, and the Tax Court found that he did not, his gross receipts would have had to have reached $20,000,000.00 to have approximated the income "determined" by Respondent. The Tax Court, which resolved any reasonable doubts against the taxpayer and reconstructed his gross income at a figure which, in its judgment, his

income would have been unlikely to have exceeded in fact (R-Br 40) found more than four-fifths of the Respondent's determination excessive.

Third, Adrian disregarded information available to him in the Parenti audit. He secured permission from the Commissioner to reopen the two years already audited and adjusted by Parenti. He took this unusual step because of the nationwide crack-down on gambling. (R. 190.) Adrian knew that Parenti had audited Petitioner's tax returns for the years 1948 and 1949. All of Petitioner's books and records had been made available to Parenti at the time of the audit. The cancelled checks for those years, which were lost at the time of Murton's death, were available to Mr. Parenti. (R 217.) All of Petitioner's records were available to Parenti and it is worthy of note that he made no objection to Murton's method of reporting income. Respondent's attempt to pass off the Parenti audit as routine is unconvincing. Having the bank statements, which showed that Petitioner deposited $508,384.23 in the bank in 1948 and $404,-118.69 in 1949, and the cancelled checks for the two years before him, Revenue Agent Parenti did not find that the bank deposits indicated unreported income. The only additional information that Adrian had was that the taxpayer had received, and cashed or transferred, checks in the aggregate sum of $251,300.50 for 1948, 1949 and 1950. Adrian might reasonably have believed that some part of these checks constituted unreported income. He testified (R 200) that he knew that Petitioner was a betting commissioner and he

might reasonably have believed that commissions were included in these checks and thrown the burden upon Petitioner of proving how much of the total sum constituted income. He did not have the same excuse for including all of the bank deposits, even including over $131,000.00, which Petitioner had already reported. Parenti's audit and work papers must have made it perfectly clear to Adrian that all of the bank deposits did not constitute income.

Fourth, Adrian's treatment of the information that he had received concerning the Film Row Club transaction, shows that he had no interest in adopting a method which would truly reflect Petitioner's income. It must be noted that there is nothing in Adrian's testimony, or in any part of the record, to support the Tax Court's finding, and the Respondent's statement in his brief, that Petitioner indulged in personal gambling at the Film Row Club. (R 160.) The Petitioner testified, and the Tax Court found, that the Petitioner did not intentionally gamble. There is nothing in the record to support the notion of personal gambling and the Film Row Club was merely one of the many establishments with which Petitioner dealt. Knowing that Petitioner was a betting commissioner (R 200) Adrian might reasonably have determined that Petitioner made the maximum 5% commission on all Film Row Club transactions and thrown the burden of proof upon the Petitioner of proving that he made less than the maximum. This might have been rough on Petitioner, but it would not have been arbitrary on the part of the Commissioner. We must remember that

all that Adrian had was a purported schedule of wins and losses received from another Revenue Agent. He admitted that he had just as much reason to believe that the losses were authentic as he had to believe that the wins were authentic. He had no evidence whatsoever, and no reason to believe, that Petitioner ever actually collected one cent from the Film Row Club. Petitioner testified, and the Tax Court found, that Petitioner usually made periodical settlements with other betting establishments. The only logical assumption in connection with the Film Row Club would be that Petitioner paid his net losses and received nothing from the Film Row Club. Be that as it may, Adrian's treatment of the Film Row Club transaction, just as his treatment of the bank deposits, show an arbitrary disregard for the facts available to him.

Fifth, the fantastic and unrealistic amount claimed in the Deficiency Notice, the arrogant failure to state the basis of the determination in the notice, the deliberate levy of a Jeopardy Assessment of nearly $1,800,000.00, all show that the Respondent intentionally determined an arbitrary and excessive assessment as part of the nationwide crack-down on illegal gambling in 1952.

Throughout Sections A, B, and C of his brief, Respondent attempts to justify Adrian's unrealistic and arbitrary determination on the grounds that Petitioner failed to maintain adequate records, and/or, make such records available. We have already shown that the absence of books and records does not justify

an arbitrary determination. The method adopted by the Commissioner in such case must still reflect the taxpayer's income. (Sec. 22 (a) and 41, IRC 1939.) The absence of books and records does not justify the Respondent in disregarding other information which is available to him or in making a determination which he knows to be excessive. There is not the slightest reason for believing that the Respondent's determination would have been any different if the Petitioner's books and records had been made available to Adrian prior to the issuance of the ninety day letter. All of the records which Petitioner ever had (except the cancelled checks for the years 1948 and 1949, which Parenti had) were made available to Adrian and Respondent's Appellate Division prior to the trial in the Tax Court. (R 200, 203-204.) After examining Petitioner's records, the Respondent did not abate his claim by as much as five cents. His solicitude over the Petitioner's records in his brief seems a little misplaced, since he consumed a large part of the hearing before the Tax Court in opposing their introduction in evidence. (R 39, 41, 48, 52, 53, 90, 106-152.) Counsel for Respondent argued strenuously throughout the trial against the introduction of any of Petitioner's records and it is highly unlikely that Adrain would have found them any more acceptable. Murton's method of accounting for income did not purport to account for cash on the theory that the $3,000.00 cash revolving fund was relatively stable. It is quite obvious from the record in this case, and from the position taken by Respondent in other reported cases

(Louis A. Simon, p. 55324 PH Memo TC), that he would have been satisfied with nothing less than a written record giving the name and address of each person for whom Petitioner handled a bet, together with the amount of the commission received on the transaction. In the absence of such records, the Commissioner is empowered under the statute to adopt a method of accounting which will clearly reflect income, but he may not use such method to levy an arbitrary and excessive assessment.

C.

Under this heading the Respondent's brief says, "The Tax Court properly redetermined the volume of the taxpayer's bets handled and the gross commissions received thereon on the basis of his bank deposits for each of the three taxable years involved."

This section of Respondent's brief contains a glaring misstatement of fact. On page 35 he states that we contend that the Tax Court erred in treating bank deposits as gross income without allowing any deductions or eliminations therefrom for pay-outs. We made no such contention and the pages referred to, 37-41, are directed solely to the Respondent's original determination and not to the decision of the Tax Court. The Tax Court, unlike the Commissioner, did not treat gross receipts as gross income but attempted to ascertain Petitioner's commissions.

A second error in Respondent's brief has to do with the introduction of the Petitioner's records into evidence. Perhaps because the Respondent's case was

handled before the Tax Court by attorneys in the Bureau of Internal Revenue, Respondent's counsel before this Court appeared to be under a complete misapprehension in this matter. Respondent's brief not only states that the taxpayer refused to introduce his own records at the Tax Court hearing, but argues from that that the clear implication is that such documents, if offered, would have been detrimental to his case. The fact is, and the transcript clearly shows, that all of Petitioner's records were offered into evidence in the Tax Court, with the exception of the cancelled checks for the years 1948 and 1949, and those were lost.

The idea that the taxpayer attempted to withhold any documents before the Tax Court is grimly amusing to anyone who takes the trouble to read the entire transcript of proceedings before the Tax Court. Most of the trial time before the Tax Court was used by Petitioner's attorney in trying to get into evidence such records as the Petitioner had, over the vociferous and repeated objections of the attorney for the Respondent. The only books that were not actually offered in evidence were the so-called gray books, which constituted the original books of entry for the cardroom. Summaries of these books were placed in evidence (R 80), and counsel offered the books for verification by Respondent's agents. There was, in fact, no controversy ever raised about the authenticity of the cardroom records, and therefore, as is customary in Tax Court practice, counsel for Petitioner merely placed a summary of the books in evidence

and did not clutter the record with the original books themselves. Evje's testimony, which was not contradicted in any manner and which was accepted in toto by the Tax Court, shows what records were maintained under Murton's method of accounting for income, and all of these records were offered in evidence, and were admitted into evidence, with the two exceptions above mentioned, i.e., the cancelled checks for the years 1948 and 1949, which were lost when Murton died, and the gray books, of which summaries are in evidence. If counsel for Respondent had read Mr. Evje's testimony concerning what records were actually kept, and then checked the exhibits on file, they would not have made the utterly unfounded charges that Petitioner had failed to offer such records as he had.

Respondent's brief correctly states that taxpayer's fundamental objection to the results arrived at by the Tax Court is that the Tax Court erred in holding that he had failed to show that Commissioner's determination of deficiencies was arbitrary and invalid and that the burden was on the taxpayer to establish that he did not owe the amounts determined by the Commissioner in the Deficiency Notice. For the reasons set forth here and in our Opening Brief we believe that this contention is correct and that the undisputed facts in the record show that the Commissioner's determination was arbitrary. We have pointed out at various places, supra, that Respondent has failed to claim that the original Deficiency Notice by the Respondent was not arbitrary and excessive.

Respondent has not attempted to answer Petitioner's contention that the original determination was arbitrary. (R-Br 42.) "We believe that a detailed discussion of the numerous items of income, etc., complained of variously by the taxpayer (Br 32-53) which were given full consideration and effect by the Commissioner in his determination and by the Tax Court in its findings and redetermination (R 207-243) is unnecessary". The pages of Petitioner's Opening Brief referred to cover all of the reasons why the Respondent's original determination was arbitrary and also a discussion of the errors in the findings of the Tax Court. Since Respondent has not discussed these matters, we shall submit them to the Court on the basis of our original brief. We can only note that the Respondent has made no attempt to answer the arguments contained in the portion of our opening brief referred to.

II.

In this section of his brief Respondent states: "The Tax Court correctly found, upon the entire record, that a part of the deficiencies in taxes were due to fraud with intent to evade taxes". In discussing the fraud issue the Respondent's brief advances no arguments that the Tax Court's opinion did not present with greater clarity and much less wordage. Our answer to the Tax Court argument in our opening brief is equally applicable to Respondent's argument here. All of the arguments in support of the fraud penalties are based upon one erroneous premise, that is, that there is sufficient clear and convincing evi-

dence in the record, unaided by the Commissioner's presumption, to support the Tax Court's findings.

Respondent has failed to distinguish between findings made upon clear and convincing evidence and findings based merely upon Petitioner's alleged failure to carry the burden of proof. For example, Respondent says (R-Br 48): "Specifically, the Tax Court found, upon the evidence, that the taxpayer had understated and failed to report taxable income in the total amounts of $110,204.87, $78,725.09, and $99,792.29 . . .". Of course, the Tax Court found nothing of the kind *upon the evidence.* The Tax Court found that it was unlikely that Petitioner's income had, in fact, exceeded specific sums in the respective years and that he had failed to prove that it was a lesser amount. This is a far different thing than a finding based upon the evidence in the case. Without the aid of the presumption which the Tax Court said existed in favor of the Commissioner's determination, the Tax Court could not have found a deficiency for a single cent.

The Tax Court based its crucial findings upon "a painstaking analysis of all of the evidence in this case" (R 245) and the evidence so analyzed is listed by the Court as follows:

1. "The minimum volume of lay-off bets indicated by the deposit of checks and money orders from out-of-town betting commissioners"; and "undeposited checks and money orders from the same sources";

2. "Checks of Petitioner to betting commissioners";

3. "The fact that the remittances to and from Petitioner usually represented the settling of accounts rather than individual bets";

4. "The added fact that Petitioner's local cash business was a substantial part of his betting commissioner's activities,"

5. "Recognizing the percentages he received,"

6. "And making allowance for splitting of commissions on out-of-town business,"

7. "Occasional foregoing of commissions,"

8. "Occasional losses,"

9. "And the fact that Petitioner received commissions on horse race bets only from the loser,".

It is obvious that there is no clear and convincing affirmative evidence in the record which would enable the Tax Court's "painstaking analysis" to be anything but a mere guess. The income taxes reported, and paid, by Petitioner for the three years in question could have required a volume of bets in excess of $5,000,000.00. There is nothing in the record upon which the Tax Court could conclude, from clear and convincing evidence, that Petitioner's gross volume exceeded $5,000,000.00 for the three years. If the Tax Court thought that there was such evidence it should have made specific and definitive findings to that effect. Let us examine in detail each of the factors that the Tax Court said that it took into consideration:

1. *The minimum volume of lay-off bets indicated by the deposit of checks and money orders from out-of-town betting commissioners.* The total amount of

the checks deposited in the bank was $1,195,632.72 and the checks received and cashed or endorsed to others totaled $251,300.50, and the cash deposited in the bank was $22,895.00. (R-Br 26.) Thus the total volume of such bets actually proved in the record by clear and convincing evidence is less than $1,500,000.00 for the entire three years.

2. *Checks of Petitioners to betting commissioners.* The Court found that these checks for the year 1950 exceeded $290,000.00. There is no clear and convincing evidence as to what checks were issued in 1948 and 1949. However, if we assume that the same general pattern of payment by check existed in 1948 and 1949, the total amount might aggregate $1,000,000.00.

3. *The fact that the remittances to and from Petitioner usually represented the settling of accounts rather than individual bets.* Just how the Court could take this matter into consideration is not clear. There is no clear and convincing, nor in fact any, evidence before the Court which would enable the Court to make any findings in this respect. Any specific check might have been in settlement of one bet, or two bets, or more than two bets. It is ridiculous for the Tax Court to say that it took into consideration a factor concerning which there was not one iota of evidence.

4. *The added fact that Petitioner's local cash business was a substantial part of his betting commissioner's activities.* Although there is no evidence on the point, the Court assumed that the volume of local business would at least equal the volume of out-of-town business. If this were true, the total would still

be within the possible $5,000,000.00 total; that is, $1,500,000.00 for the bank deposits and checks cashed, $1,000,000.00 for pay-outs to commissioners, and $2,-500,000.00 for local bets.

5. *Recognizing the percentages he received.* Presumably the Court is referring to the maximum commission of 5%.

6. *And making allowance for splitting of commissions on out-of-town business.* How could the Tax Court make any allowance for splitting commissions in the absence of any specific evidence in the record? The only testimony is to the fact that Petitioner laid off bets when he could not place them locally. This would indicate that virtually all out-of-town bets required a splitting of the commission with the out-of-town broker.

7. *Occasional foregoing of commissions.* Obviously, the Tax Court had no evidence as to how many times, or in what proportions, Petitioner was compelled to forego commissions.

8. *Occasional losses.* Petitioner testified to substantial losses due to his inability to collect from brokers in 1950. The Court does not tell us to what extent it took losses into account and except for the year 1950 there is no evidence in the record which would enable the Court to properly take losses into account.

9. *And the fact that Petitioner received commissions on horse race bets only from the loser.* This is a crucial point in the "painstaking analysis". This might make several millions of dollars difference in

the gross handle and the Court says that it took the matter into consideration. In the absence of specific findings we do not know to what extent the Court took this matter into consideration, but it is obvious that whatever consideration it gave was simply a guess, unsupported by any clear and convincing evidence in the record. The Tax Court says in its opinion that in making this painstaking analysis it resolved any doubts against the Respondent with whom the burden of proof of fraud lies. (R 245-246.) We would understand from this that the Tax Court took that view of the evidence which would be most favorable to Petitioner. Therefore, it should have determined that the greater proportion of Petitioner's business consisted of bets on horse races and this is undoubtedly the fact as demonstrated in our opening brief. (P-Br 48.) Then the Court should have found (if it were really resolving all doubts against the Commissioner) that Petitioner was compelled to split the commissions on horse races with out-of-town brokers. In other words, Petitioner's net commissions on horse race bets, which were laid off with out-of-town brokers, could only average about one and one-quarter per cent. Five per cent on the loser's side of the horse race bet in the long run should average out about 2½% of the entire bet and one-half of that to the out-of-town broker would leave the Petitioner with one and one-quarter per cent.

The Court also said, "Our analysis likewise convinces us that a large part of the understatements in each of the said years was attributable to Petitioner's

failure to include in his return the receipts of commissions in cash". (R 246.) This conclusion is likewise unsupported by any clear and convincing evidence. The record shows that Petitioner used cash to purchase cashier's checks and money orders to pay out-of-town bettors. (R 211.) The record does not show how much cash was expended in this manner, but if the Tax Court is really going to resolve all doubts against the Respondent upon whom the burden of proof lies, it would have to have that information and make a specific finding thereon. Petitioner testified that he maintained his cash balance at around $3,000.00. The Tax Court says that an analysis of the facts demonstrates the contrary, but unfortunately it fails to find facts to support its conclusion.

Murton's method of accounting for income would account for all of Petitioner's income from commissions if it were honestly carried out, that is to say it would account for all net receipts unless Petitioner secreted cash over and above the $3,000.00 revolving fund. There is no clear and convincing evidence in the record that he did so. His net worth, his manner of living, and the amount of income reported on his income tax returns are entirely consistent with his having reported all of his commissions. Whether or not this Court sustains the deficiencies in income taxes found by the Tax Court depends largely upon whether or not it agrees with the Tax Court that the Commissioner's original determination was not arbitrary. We do not have the same problem in connection with the fraud penalties. The Tax Court recognizes that all

doubts must be resolved against the Commissioner who has the burden of proving fraud, but as we have demonstrated above, it failed to do so. There is no clear and convincing evidence in the record, resolving all doubts against the Respondent, which would justify a finding that there was any deficiency in income taxes for any of the three years. Since no deficiencies were proven, Respondent's argument that the intent to evade tax may be inferred from a continuous failure to report income is inapplicable.

CONCLUSION.

For the reasons set forth herein, and in our opening brief, we submit that the judgment of the Tax Court should be reversed.

Dated, San Francisco, California,
September 29, 1958.

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
Attorneys for Petitioner.

No. 15983

United States
Court of Appeals
for the Ninth Circuit

THOMAS M. ROBINSON, Appellant,

vs.

WILLIAM G. ELLIOT, Appellee.

Transcript of Record

(In Two Volumes)

VOLUME I.

(Pages 1 to 103, inclusive)

Appeal from the United States District Court
for the District of Montana

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—6-5-58

No. 15983

United States
Court of Appeals
for the Ninth Circuit

THOMAS M. ROBINSON, Appellant,

vs.

WILLIAM G. ELLIOT, Appellee.

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Appeal from the United States District Court
for the District of Montana

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Billings, Montana,

Attorneys for Appellees.

In the United States District Court, District of Montana, Billings Division

No. 1727

WILLIAM G. ELLIOT, Plaintiff,

vs.

THOMAS M. ROBINSON, Defendant.

COMPLAINT

Plaintiff, by his attorneys, for his complaint herein alleges:

(1) This complaint is filed and this action is instituted pursuant to the provisions of Section 322 of the Internal Revenue Code of 1939 (U.S.C. Title 26, Sec. 322), and Section 6402 of the Internal Revenue Code of 1954 for the recovery of Federal income taxes and interest thereon, paid for the calendar years 1946, 1947, 1948, 1949, 1950, 1951, 1952 and 1953.

(2) The plaintiff is an individual, residing at the Northern Hotel, Billings, Montana, and is a resident of the District of Montana.

(3) This action against Thomas M. Robinson, U. S. District Director of Internal Revenue for the District of Montana, arises under the Act of June 25, 1948, 62 Stat. 932, United States Code, Title 28, Sec. 1340.

(4) This action arises under the laws of the

United States, to wit: Section 117 of the Internal Revenue Code of 1939.

(5) The Plaintiff duly filed his Federal income tax return for the calendar year 1946 with the above-named defendant. The plaintiff paid, on or before March 15, 1947, the amount of $1,985.67, the Federal income tax for 1946 shown to be due by said return.

(6) The Plaintiff filed with the defendant a claim for refund of $1,041.97 income tax paid for the year 1946. A true copy of said claim for refund is attached hereto and marked Exhibit "A".

(7) The plaintiff duly filed his Federal income tax return for the calendar year 1947 with the above named defendant. The plaintiff paid on or before March 15, 1948, the amount of $2,353.71, the Federal income tax shown to be due by said return. On or about November 16, 1950, pursuant to a notice and demand received from the above-named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1947 in the amount of $342.33, together with interest thereon of $52.30, said payments being made to the above-named defendant.

(8) On or before March 15, 1951, the plaintiff duly filed with the defendant a timely claim for refund of $1,376.81, income tax paid for the year 1947. A true copy of said claim for refund is attached hereto and marked Exhibit "B".

(9) The plaintiff duly filed his Federal income

tax return for the calendar year 1948 with the above named defendant. The plaintiff paid on or before March 15, 1949, the amount of $2,189.30, the Federal income tax shown to be due by said return. On or about November 16, 1950, pursuant to a notice and demand received from the above named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1948 in the amount of $1,056.44, together with interest thereon of $98.03, said payments being made to the above-named defendant.

(10) On or before March 15, 1952, the plaintiff duly filed with the defendant a timely claim for refund of $1,527.52, income tax paid for the year 1948. A true copy of said claim for refund is attached hereto and marked Exhibit "C".

(11) The plaintiff duly filed his Federal income tax return for the calendar year 1949 with the above-named defendant. The plaintiff paid on or before March 15, 1950, the amount of $2,454.60, the Federal income tax shown to be due by said return. During the calendar year 1953 and pursuant to a notice and demand received from the above-named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1949 in the amount of $512.30, together with interest of $120.11, said payments being made to the above-named defendant.

(12) On or before March 15, 1953, the plaintiff duly filed with the defendant a timely claim for refund of $940.30, income tax paid for the year 1949. A true copy of said claim for refund is at-

tached hereto and marked Exhibit "D". On or about March 15, 1953, the plaintiff duly filed with the defendant a timely amended claim for refund of $2,454.60 or such other amount as is legally refundable, plus interest, for the year 1949. A true copy of said claim for refund is attached hereto and marked Exhibit "E".

(13) The plaintiff duly filed his Federal income tax return for the calendar year 1950 with the above-named defendant. The plaintiff paid on or before March 15, 1951, the amount of $3,281.31, the Federal income tax shown to be due by said return. During the calendar year 1953 and pursuant to a notice and demand received from the above-named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1950 in the amount of $79.14, together with interest thereon of $13.81, said payment being made to the above-named defendant.

(14) On or before March 15, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $1,525.48, income tax paid for the year 1950. A true copy of said claim for refund is attached hereto and marked Exhibit "F". On or before March 15, 1954, the plaintiff duly filed with the defendant a timely amended claim for refund of $3,360.45 or such other amount as is legally refundable, plus interest, for the taxable year 1950. A true copy of said claim for refund is attached hereto and marked Exhibit "G".

(15) The plaintiff duly filed his Federal income tax return for the calendar year 1951 with the

above-named defendant. The plaintiff paid, on or before March 15, 1952, the amount of $3,865.43, the Federal income tax shown to be due by said return.

(16) On or about July 8, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $3,865.43, income tax paid for the year 1951. A true copy of said claim is attached hereto and marked Exhibit "H".

(17) The plaintiff duly filed his Federal income tax return for the calendar year 1952 with the above-named defendant. The plaintiff paid on or before March 15, 1953, the amount of $4,315.39, the Federal income tax shown to be due by said return.

(18) On or about July 8, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $4,315.39, income tax paid for the year 1952. A true copy of said claim is attached hereto and marked Exhibit "I".

(19) The plaintiff duly filed his Federal income tax return for the calendar year 1953 with the above-named defendant. The plaintiff paid, on or before March 15, 1954, the amount of $4,179.30, the Federal income tax shown to be due by said return.

(20) On or about July 8, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $4,179.30, income tax paid for the year 1953. A true copy of said claim is attached hereto and marked Exhibit "J".

(21) The Commissioner of Internal Revenue dis-

allowed the claims for refund for 1946, 1947, 1948 and 1949. This complaint is filed within two years of the time of the receipt of all of the statutory disallowances of the aforesaid refund claims.

(22) On January 14, 1946, the plaintiff together with Thomas W. Elliot and his wife, Evelyn W. Elliot, transferred to the F. A. Buttrey Company, a Montana corporation, certain real estate and a business building located thereon in Kalispell, Montana. The total consideration was payable commencing on February 1, 1946, at the rate of $19,000.00 a year for ten (10) years, at which time a final payment of $75,000.00 would be payable unless the buyer elected not to make the final payment, in which event the deed to the said property would be returned to the sellers by the escrow holder thereof. Said transfer was carried out pursuant to an agreement between the above-described parties. Said agreement was entitled "Lease Agreement and Purchase Option" and it was executed on January 14, 1946. Said agreement is expressly incorporated herein by reference and a true copy of same is hereto attached and marked Exhibit "K". A subsequent agreement between the above named parties entitled "Memorandum Agreement" was executed on February 1, 1946 and said agreement is expressly incorporated herein by reference and a true copy is attached hereto and marked Exhibit "L".

(23) The plaintiff was and is entitled to $10,000.00 a year out of the $19,000.00 yearly payments and to $39,473.68 of the final payment of $75,000.00.

The amount received by the plaintiff in 1946 was $10,000.00.

(24) Prior to entering into the agreements with the F. A. Buttrey Company referred to in paragraph (22) above, the plaintiff owned an undivided one-half interest in the above-described property. Said property had been held by the plaintiff for more than six months. The plaintiff's adjusted basis for determining gain under the Internal Revenue Code of 1939 with respect to said property was $19,321.63 on January 14, 1946.

(25) The Commissioner of Internal Revenue, in disallowing the 1946 claim for refund, erroneously treated the $10,000.00 received by the plaintiff in 1946 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(26) The plaintiff in 1947 received $10,000.00 pursuant to the agreements set forth in paragraph (22) above.

(27) The Commissioner of Internal Revenue, in disallowing the 1947 claim for refund, erroneously treated the $10,000.00 received by the plaintiff in 1947 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(28) The plaintiff in 1948 received $10,000.00 pursuant to the agreement set forth in paragraph (22) above.

(29) The Commissioner of Internal Revenue, in disallowing the 1948 claim for refund, erroneously treated the $10,000.00 received by the plaintiff in 1948 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(30) The plaintiff in 1949 received $10,000.00 pursuant to the agreements set forth in paragraph (22) above.

(31) The Commissioner of Internal Revenue, in disallowing the 1949 claim for refund, erroneously treated the $10,000.00 received by the plaintiff in 1949 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(32) The plaintiff in 1950 received $10,000.00 pursuant to the agreements set forth in paragraph (22) above.

(33) The Commissioner of Internal Revenue, in disallowing the 1950 claim for refund, erroneously treated the $10,000.00 received by the plaintiff in 1950 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 119 of the Internal Revenue Code of 1939.

(34) The Commissioner of Internal Revenue has taken no action to date regarding the claims for refund for the years 1951, 1952 and 1953. This com-

plaint is filed after a period of six months has elapsed since the filing of each of the refund claims for the aforesaid years.

(35) The plaintiff, in each of the years 1951, 1952 and 1953, received $10,000.00 pursuant to the agreements set forth in paragraph (22) above. Said amounts were erroneously reported and taxed in the plaintiff's Federal income tax return for 1951, 1952 and 1953 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(36) By virtue of the aforesaid, the defendant becomes and is indebted to the plaintiff for $1,041.97, income tax paid for the calendar year 1946, and for $1,429.11 income tax paid together with interest paid thereon, for the calendar year 1947, and for $1,626.55 income tax paid, together with interest paid thereon, for the calendar year 1948, and for $2,532.14 income tax paid, together with interest paid thereon, for the calendar year 1949, and for $2,648.23 income tax paid, together with interest paid thereon, for the calendar year 1950, and for $2,989.97 income tax paid for the calendar year 1951, and for $3,367.33 income tax paid for the calendar year 1952, and for $3,023.56 income tax paid for the calendar year 1953, which amounts have not heretofore been refunded or credited, together with interest on such amounts as provided by law.

Wherefore, the plaintiff demands judgment

against the defendant in the amount of $18,658.86 with interest thereon as provided by law, together with the costs of this action.

Dated May 23, 1955.

FELT, FELT & BURNETT,
/s/ By JAMES R. FELT,
Attorneys for Plaintiff.

EXHIBIT "A"

(Copy)

CLAIM

* * * * *

State of Montana,
County of Yellowstone—ss.

Name of taxpayer or purchaser of stamps: Wm. G. Elliot.

Return address: Kalispell, Montana.

Present Residence: Northern Hotel, Billings, Montana.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Montana.

2. Period: (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1946, to Dec. 31, 1946.

Exhibit "A"—(Continued)

3. Character of assessment or tax: Individual Income.

4. Amount of assessment, $1,985.67; dates of payment: Not available.

5. Date stamps were purchased from the Government.....

6. Amount to be refunded: $1,041.97.

7. Amount to be abated (not applicable to income, gift, or estate taxes):.....

8. The time within which this claim may be legally filed expires, under section 322(b) of Internal Revenue Code, is unknown.

The deponent verily believes that this claim should be allowed for the following reasons: As stated in schedules and exhibits attached hereto, and made a part of this claim, as follows:

Schedule No. 1		Page 1.
Schedule No. 1-a		Page 2.
Schedule No. 2		Page 3.
Exhibit A		Page 4.
Exhibit A-1	1950 Claim	Page 5.

* * * * *

Exhibit "A"—(Continued)

Page

WILLIAM G. ELLIOT
Billings, Montana

Adjustments—1946
Schedule 1

Items—Income	Return	Additions	Deductions	Correcte
1. Salary & Wages	$ 1,500.00	$	$	$ 1,500.0
2. Dividends	2,027.00			2,027.0
3. Net Gain—Capital Assets		4,270.88		4,270.8
4. Buffalo Block	11,393.52		8,833.64	2,559.8
5. Adjusted Gross Income	$14,920.52			$10,357.7
6. Deductions				
7. Contributions	$ 2,238.00			$ 2,238.0
8. State Income Tax	29.86			29.8
9. Medical Expense	2,500.00			2,500.0
10. Travel Expense	769.80	769.80		
11. Total Deductions	$ 5,537.66			$ 4,767.8
12. Net Income	$ 9,382.86	$5,040.68	$8,833.64	$ 5,589.9

Page 2

Adjustments Explained—1946
Schedule 1-a

Item 3. Net Gain—Capital Assets	$4,270.88
Previously Reported	None
Adjustment	$4,270.88

Gain on sale of property on installment basis as determined in Exhibit-A attached hereto, is based upon facts and interpretation of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiation, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of

Exhibit "A"—(Continued)

the ten-year period for $75,000.00, or a total of $265,000.00. Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Item 4. Buffalo Block, reported	$8,833.64
Corrected	None
Adjustment	$8,833.64

See explanation for Item 3, reporting gain on Installment sale of Capital Assets, in lieu of rentals, as reported under Item 4 in error.

Item 10. Travel Expenses, reported	$ 769.80
Corrected	None
Adjustment	$ 769.80

Deduction withdrawn as a result of R.A.R., 9/20/50, as to travel expense.

NOTE: Records could not be found as to date of filing of original return. Claim is therefore filed since the time within which this claim may be legally filed, is uncertain.

Relief is also sought under provisions of Section 275(c) Internal Revenue Code upon the same grounds, although not now so provided.

Page 3

Tax Computation—1946
Schedule 2

Net Income from Schedule No. 1	$5,589.90	
Less: Exemptions (2)	1,000.00	
Taxable Net Income	$4,589.90	
Combined Tentative Normal Tax and Surtax		$ 993.37
Less: 5%		49.67
Total Tax—Corrected		$ 943.70

Exhibit "A"—(Continued)

		Corrected
Corrected Assessment		$ 943.70
Income Tax Withheld	$ 163.20	
Paid on Estimate	3,582.66	
Assessed on Return	(1,760.19)	
		1,985.67
Overassessment Claimed		$ 1,041.97

EXHIBIT A

WM. G. ELLIOT
Billings, Montana

T. W. ELLIOT
Kalispell, Montana

Page

Net Gain—Gain of Capital Assets

Sale Price			$265,000
Cost			
Land		$15,000.00	
Buildings	$68,000.00		
Improvements—1924			
1925			
1929	5,873.79		
	$73,873.79		
Less: Depreciation Reserve			
12/31/45 per R.A.R.	$50,054.17		
1/1 to 1/31/46	176.35		
	50,230.52		
		23,643.27	
			38,643
Net Profit of Sale			$226,356

Exhibit "A"—(Continued)

		Installments	Reportable Profit	Taxable Profit
Payments	2/1/46	$ 19,000.00	$ 16,229.35	$ 8,114.68
	2/1/47	19,000.00	16,229.35	8,114.68
	2/1/48	19,000.00	16,229.35	8,114.68
	2/1/49	19,000.00	16,229.35	8,114.68
	2/1/50	19,000.00	16,229.35	8,114.68
	2/1/51	19,000.00	16,229.35	8,114.68
	2/1/52	19,000.00	16,229.35	8,114.68
	2/1/53	19,000.00	16,229.35	8,114.68
	2/1/54	19,000.00	16,229.35	8,114.68
	2/1/55	19,000.00	16,229.35	8,114.68
	2/1/56	75,000.00	64,063.23	32,061.62
		$265,000.00	$226,356.73	$113,208.42

Summary

Wm. G. Elliot—1946-55	$10,000.00	$ 4,270.88	$42,708.80
Wm. G. Elliot—1956	39,473.68	16,874.54	16,874.54
Tom Elliot—1946-55	9,000.00	3,843.80	38,438.00
Tom Elliot—1956	35,526.32	15,187.08	15,187.08
			$113,208.42

EXHIBIT "B"

(Copy)

CLAIM

* * * * *

State of Montana,
County of Yellowstone—ss.

Name of taxpayer or purchaser of stamps: Wm. G. Elliot.

Return address: Kalispell, Montana.

Present Residence: Northern Hotel, Billings, Montana.

The deponent, being duly sworn according to law,

Exhibit "B"—(Continued)

deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1947, to Dec. 31, 1947.

3. Character of assessment or tax: Individual Income.

4. Amount of assessment: $2,696.04; dates of payment: Not available.

5. Date stamps were purchased from the Government.....

6. Amount to be refunded: $1,376.81.

7. Amount to be abated (not applicable to income, gift, or estate taxes):.....

8. The time within which this claim may be legally filed expires, under section 322(b) of Internal Revenue Code, on March 15, 1951.

The deponent verily believes that this claim should be allowed for the following reasons: As stated in schedules and exhibits attached hereto and made a part of this claim, as follows:

Schedule No. 1		Page 1.
Schedule No. 1-a		Page 2.
Schedule No. 2		Page 3.
Exhibit A		Page 4.
Exhibit A-1	1950 Claim	Page 5.

* * * * *

Exhibit "B"—(Continued)

WM. G. ELLIOT
Billings, Montana

Adjustments—1947
Schedule 1

Page 1

Items—Income	R.A.R. 9/20/50	Additions	Deductions	Corrected
Salary & Wages	$ 1,500.00	$	$	$1,500.00
Dividends	2,817.00			2,817.00
Net Gain—Capital Assets		4,270.88		4,270.88
Joint Ownership	8,752.74		8,752.74	
Adjusted Gross Income	$13,069.74			$8,587.88
Deductions				
Contributions	$ 840.00			$ 840.00
State Income Tax	154.67			154.67
Medical Expense	1,054.18		195.82	1,250.00
Travel Expenses			80.90	
Total Deductions	$ 2,048.85			$2,244.67
Net Income	$11,020.89	$4,270.88	$8,948.56	$6,343.21

Adjustments Explained—1947
Schedule 1-a

Page 2

Item 3. Net Gain—Capital Assets, Corrected	$4,270.88
Reported	None
Adjustment	$4,270.88

Gain on sale of property on installment basis as determined in Exhibit A attached hereto, is based upon facts and interpretation of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiation, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of the ten-year period for $75,000.00, or a total of $265,000.00.

Exhibit "B"—(Continued)

Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Item 4. Joint Ownership, Reported		$8,572.74
Corrected		None
Adjustment		$8,572.74

See explanation for Item 3, reporting gain on Installment sale of Capital Assets, in lieu of rentals, as reported under Item 4 in error.

Item 9. Medical Expense, Corrected		$1,250.00
Reported		1,054.18
Adjustment		$ 195.82
Medical Expense Listed	$1,707.67	
Adjusted Gross Income—$6,343.21		
Less: 5% of Adjusted Gross Income	126.86	
	$1,580.81	
Excess over limitation of $1,250.00	330.81	
Corrected Deduction	$1,250.00	
Item 10. Travel Expense, Corrected		$ 80.90
Reported		None
Adjustment		$ 80.90

This covers travel expense included under Item 4, in R.A.R., which item is now removed in full. Travel is now claimed under Item 10, as Investor's expense.

Page 3

Tax Computation—1947
Schedule 2

Net Income from Schedule No. 1	$6,343.21	
Less: Exemptions (1)	500.00	
Taxable Net Income	$5,843.21	

Exhibit "B"—(Continued)

Combined Tentative Normal Tax and Surtax		$1,319.23
Income Tax Withheld	$ 163.10	
Paid on Estimate	2,857.80	
Assessed, Original Return	(667.19)	
Assessed, R.A.R., 9/20/50	342.33	
		2,696.04
Overassessment Claimed		$1,376.81

[Note: Exhibit A—Net Gain—Sale of Capital Assets is the same as set out at pages 16-17.]

EXHIBIT "C"

(Copy)

CLAIM

State of Montana,
County of Yellowstone—ss.

Name of taxpayer or purchaser of stamps: Wm. G. Elliot.

Return address: Kalispell, Montana.

Present Residence: Northern Hotel, Billings, Montana.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Montana.

Exhibit "C"—(Continued)

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1948, to Dec. 31, 1948.

3. Character of assessment or tax: Individual Income.

4. Amount of assessment, $3,145.74; dates of payment: Not available.

5. Date stamps were purchased from the Government:.....

6. Amount to be refunded: $1,528.52.

7. Amount to be abated (not applicable to income, gift, or estate taxes):.....

8. The time within which this claim may be legally filed expires, under section 322(b) of Internal Revenue Code on March 15, 1952.

The deponent verily believes that this claim should be allowed for the following reasons: As stated in schedules and exhibits attached hereto and made a part of this claim, as follows:

Schedule No. 1		Page 1.
Schedule No. 1-a		Page 2.
Schedule No. 2		Page 3.
Exhibit A		Page 4.
Exhibit A-1	1950 Claim	Page 5.

* * * * *

Exhibit "C"—(Continued)

Wm. G. Elliot
Billings, Montana

Adjustments—1948
Schedule 1

Page 1

Items—Income	R.A.R. 9/20/50	Additions	Deductions	Corrected
Salaries & Wages	$ 1,500.00	$	$	$1,500.00
Dividends	3,245.00			3,245.00
Interest	900.00			900.00
Net Gain—Capital Assets		4,270.88		4,270.88
Joint Ownership	8,833.64		8,833.64	
Adjusted Gross Income	$14,478.64			$9,915.88
Deductions				
Contributions	$ 250.00			$ 250.00
Interest	84.09			84.09
State Income Tax	193.94			193.94
Medical Expense	291.46		228.14	519.60
Total Deductions	$ 819.49			$1,047.63
Net Income	$13,659.15	$4,270.88	$9,061.78	$8,868.25

Exhibit "C"—(Continued)

Adjustments Explained—1948

Schedule 1-a

Page 2

Item 4.	Net Gain—Capital Assets, Corrected	$4,270.88
	Reported	None
	Adjustment	$4,270.88

Gain on sale of property on installment basis as determined in Exhibit A attached hereto, is based upon facts and interpretation of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiation, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of the ten-year period for $75,000.00, or a total of $265,000.00. Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Item 5.	Joint Ownership, Reported	$8,833.64
	Corrected	None
	Adjustment	$8,833.64

See explanation for Item 4, reporting gain on Installment sale of Capital Assets, in lieu of rentals, as reported under Item 5 in error.

Item 10.	Medical Expense, Corrected		$ 519.60
	Reported		291.46
	Adjustment		$ 228.14
	Medical Expense Listed	$1,015.39	
	Corrected Adjusted Gross Income—$9,915.88		
	Unallowable—5% of Adjusted Gross	495.79	
	Allowable Deduction		$ 519.60

Exhibit "C"—(Continued)

Tax Computation—1948

Schedule 2

Page 3

Net Income from Schedule No. 1	$8,868.25	
Less: Exemptions (2)	1,200.00	
Taxable Net Income	$7,668.25	
Combined Normal Tax and Surtax		$1,860.48
Less: Reduction—12% plus $20.00		243.26
Total Income Tax—Corrected		$1,617.22
Income Tax Withheld	$ 138.40	
Paid on Estimate	1,162.50	
Credit, prior year	667.19	
Assessed on Return	121.21	
Assessed, R.A.R., 9/20/50	1,056.44	
		3,145.74
Overassessment Claimed		$1,528.52

[Note: Exhibit A—Net Gain—Sale of Capital Assets is the same as set out at pages 16-17.]

EXHIBIT "D"

(Copy)

CLAIM

* * * * *

State of Montana,
County of Yellowstone—ss.

Name of taxpayer or purchaser of stamps: Wm. G. Elliot.

Return address: Kalispell, Montana.

Present Residence: Northern Hotel, Billings, Montana.

Exhibit "D"—(Continued)

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1949, to Dec. 31, 1949.

3. Character of assessment or tax: Individual Income.

4. Amount of assessment, $2,454.60; dates of payment: Not available.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $940.30.

7. Amount to be abated (not applicable to income, gift, or estate taxes): .....

8. The time within which this claim may be legally filed expires, under section 322(b) of Internal Revenue Code on March 15, 1953.

The deponent verily believes that this claim should be allowed for the following reasons: As stated in schedules and exhibits attached hereto and made a part of this claim, as follows:

Schedule No. 1		Page 1.
Schedule No. 1-a		Page 2.
Schedule No. 2		Page 3.
Exhibit A		Page 4.
Exhibit A-1	1950 Claim	Page 5.

* * * * *

Exhibit "D"—(Continued)

Page 1

Wm. G. Elliot
Billings, Montana

Adjustments—1949
Schedule 1

Items—Income	Return	Additions	Deductions	Corrected
Salaries & Wages	$ 1,500.00	$	$	$1,500.00
Dividends	2,197.00			2,197.00
Interest	1,050.00			1,050.00
Net Gain—Capital Assets		4,270.88		4,270.88
Buffalo Block	10,000.00		10,000.00	
Adjusted Gross Income	$14,747.00			$9,017.88
Deductions				
Contributions	$ 200.00			$ 200.00
Interest	34.70			34.70
State Income Tax	304.52			304.52
Hotel Expense, Billings	2,555.00	2,555.00		
Total Deductions	$ 3,094.22			$ 539.22
Net Income	$11,652.78	$6,825.88	$10,000.00	$8,478.66

Page 2

Adjustments Explained—1949
Schedule 1-a

Item 4. Net Gain—Capital Assets, Corrected	$ 4,270.88
Reported	None
Adjustment	$ 4,270.88

Gain on sale of property on installment basis as determined in Exhibit A attached hereto, is based upon facts and interpretation of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiation, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of the ten-year period for $75,000.00, or a total of $265,000.00. Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Exhibit "D"—(Continued)

Item 5. Buffalo Block, Reported	$10,000.00
Corrected	None
Adjustment	$10,000.00

See explanation for Item 4, reporting gain on Installment sale of Capital Assets, in lieu of rentals, as reported under Item 5 in error.

Item 10. Hotel Expense, Reported	$ 2,555.00
Corrected	None
Adjustment	$ 2,555.00

Deduction withdrawn as a result of R.A.R., 9/20/50, as to travel expense.

Tax Computation—1949
Schedule 2

Page 3

Net Income from Schedule No. 1	$8,478.66	
Less: Exemptions (2)	1,200.00	
Taxable Net Income	$7,278.66	
Combined Normal Tax & Surtax Net Income		$1,743.60
Less: Reduction—12% plus $20.00		229.23
Total Income Tax—Corrected		$1,514.30
Income Tax Withheld	$ 126.00	
Payment on Estimate	1,713.54	
Assessed on Return	615.06	
		2,454.60
Overassessment Claimed		$ 940.30

[Note: Exhibit A—Net Gain—Sale of Capital Assets is the same as set out at pages 16-17.]

EXHIBIT "E"
SUPPLEMENTAL REFUND CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: William G. Elliot.

Street Address: Northern Hotel.

City, postal zone number, and State: Billings, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1949, to Dec. 31, 1949.

3. Kind of tax: Income tax.

4. Amount of assessment, $2454.60; dates of payment: by March 15, 1950.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $2454.60, or such other amount as is legally refundable, plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

The claimant believes that this claim should be allowed for the following reasons:

The original refund claim previously filed claimed capital gain treatment on payments received from certain property, using the installment basis method of computing gain on the transaction.

Exhibit "E"—(Continued)

This claim is filed to claim the right to exclude all payments received during 1949 on this transaction on the grounds that a sale occurred in 1946 and that payments received in subsequent years are not income.

For further details, reference is made to Revenue Agents Reports and other records on file with the Treasury Department.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Dated: 3-13, 1954.

/s/ WILLIAM G. ELLIOT.

EXHIBIT "F"

(Copy)

CLAIM

* * * * *

State of Montana,
County of Yellowstone—ss.

Name of taxpayer or purchaser of stamps: Wm. G. Elliot.

Business Address: Northern Hotel, Billings, Montana.

Residence: Northern Hotel, Billings, Montana.

The deponent, being duly sworn according to law, deposes and says that this statement is made on

Exhibit "F"—(Continued)

behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1950, to Dec. 31, 1950.

3. Character of assessment or tax: Individual Income.

4. Amount of assessment, $3,281.31; dates of payment: .....

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $1,525.48.

7. Amount to be abated (not applicable to income, gift, or estate taxes): .....

8. The time within which this claim may be legally filed expires, under section 322(b) of Internal Revenue Code.

The deponent verily believes that this claim should be allowed for the following reasons: As stated in schedules and exhibits attached hereto and made a part of this claim, as follows:

Schedule No. 1	Page 1.
Schedule No. 1-a	Page 2.
Schedule No. 2	Page 3.
Exhibit A	Page 4.
Exhibit A-1	Page 5.

* * * * *

Exhibit "F"—(Continued)

Pag

Wm. G. Elliot
Billings, Montana

Adjustments—1950
Schedule 1

Items—Income	Return	Additions	Deductions	Correc
1. Salary & Wages	$ 1,500.00	$	$	$ 1,500
2. Dividends	2,286.01			2,286
3. Interest	2,100.00			2,100
4. Net Gain—Capital Assets		4,270.88		4,270
5. Rents	8,833.57		8,833.57	
6. Adjusted Gross Income	$14,719.58			$10,156
Deductions				
7. Standard	$ 1,000.00			$ 1,000
8. Total Deductions	$ 1,000.00			$ 1,000
9. Net Income	$13,719.58	$4,270.88	$8,833.57	$ 9,156

Page 2

Adjustments Explained—1950
Schedule 1-a

Item 4. Net Gain—Capital Assets, Corrected	$4,270.88
Reported	None
Adjustment	$4,270.88

Gain on sale of property on installment basis as determined in Exhibit A attached hereto, is based upon facts and interpretation of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiation, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of the ten-year period for $75,000.00, or a total of $265,000.00. Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Exhibit "F"—(Continued)

Item 5. Rents, Reported	$8,833.57
Corrected	None
Adjustment	$8,833.57

See explanation for Item 4, reporting gain on Installment sale of Capital Assets, in lieu of rentals, as reported under Item 5 in error.

Page 3

Tax Computation—1950
Schedule 2

Net Income From Schedule No. 1	$9,156.89	$
Less: Exemptions (2)	1,200.00	
Taxable Net Income	$7,956.89	
Combined Normal Tax and Surtax		$1,947.07
Less: Reduction—9% plus $16.00		191.24
Total Income Tax—Corrected		$1,755.83
Income Tax Withheld	$ 132.60	
Paid on Estimate	2,328.60	
Assessed on Return	120.11	
		3,281.31
Overassessment Claimed		$1,525.48

[Note: Exhibit A—Net Gain—Sale of Capital Assets is the same as set out at pages 16-17.]

EXHIBIT "G"

CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: William G. Elliot.

Street address: Northern Hotel.

City, postal zone number, and State: Billings, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1950, to Dec. 31, 1950.

3. Kind of tax: Income.

4. Amount of assessment, $3360.45; dates of payment, March 15, 1951; 1953.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $3360.45 or such amount as is legally refundable plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

Refund of the amount described on line 6 above is hereby demanded together with interest as provided by law.

William G. Elliot, together with Thomas W. Elliot, sold a business building located in Kalispell, Montana to the F. A. Buttrey Company, a Montana corporation, on January 14, 1946. The sale price

Exhibit "G"—(Continued)

was payable, commencing on Feb. 1, 1946, at the rate of $19,000 a year for 10 years, at which time a final payment of $75,000 was payable unless the buyer elected not to make the final payment, in which event the deed to the said property would be returned to the sellers.

The taxpayer erroneously reported on their 1950 U. S. Income Tax Return the yearly payment of $19,000 received in 1950 as rental income and paid tax thereon at ordinary income tax rate.

Under the Federal income tax law, a completed sale occurred in 1946 resulting in a long term capital gain. Therefore, all payments received during 1950 are not subject to Federal income taxation.

For further details, the Revenue Agent's Reports and other records and documents on file with the Treasury Department concerning the above taxpayer and involving the taxable years 1946, 1947, 1948, and 1949 are expressly incorporated herein by reference.

* * * * *

EXHIBIT "I"

CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: William G. Elliot.

Street address: Northern Hotel.

City, postal zone number, and State: Billings, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1952, to Dec. 31, 1952.

3. Kind of tax: Income.

4. Amount of assessment, $4,315.39; dates of payment: March 15, 1953.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $4,315.39 or such amount as is legally refundable plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

The claimant believes that this claim should be allowed for the following reasons:

Refund of the amount described on line 6 above is hereby demanded together with interest as provided by law.

Exhibit "I"—(Continued)

William G. Elliot, together with Thomas W. Elliot, sold a business building located in Kalispell, Montana to the F. A. Buttrey Company, a Montana corporation, on January 14, 1946. The sale price was payable, commencing on Feb. 1, 1946, at the rate of $19,000 a year for 10 years, at which time a final payment of $75,000 was payable unless the buyer elected not to make the final payment, in which event the deed to the said property would be returned to the sellers.

The taxpayer erroneously reported on his 1952 U. S. Income Tax Return his share of the yearly payment of $19,000 received in 1952 as rental income and paid tax thereon at ordinary income tax rates.

Under the Federal income tax law, a completed sale occurred in 1946 resulting in a long term capital gain. For further details, the Revenue Agent's Reports and other records and documents on file with the Treasury Department concerning the above taxpayer and involving the taxable years 1946, 1947, 1948, 1949, and 1950, are expressly incorporated herein by reference.

* * * * *

EXHIBIT "J"

CLAIM

Name of taxpayer or purchaser of stamps: William G. Elliot.

Street address: Northern Hotel.

City, postal zone number, and State: Billings, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1953, to Dec. 31, 1953.

3. Kind of tax: Income.

4. Amount of assessment, $4,179.30; dates of payment, March 15, 1954.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $4,179.30 or such amount as is legally refundable plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

The claimant believes that this claim should be allowed for the following reasons:

Refund of the amount described on line 6 above is hereby demanded together with interest as provided by law.

William G. Elliot, together with Thomas W.

Exhibit "J"—(Continued)

Elliot, sold a business building located in Kalispell, Montana to the F. A. Buttrey Company, a Montana corporation, on January 14, 1946. The sale price was payable, commencing on Feb. 1, 1946, at the rate of $19,000 a year for 10 years, at which time a final payment of $75,000 was payable unless the buyer elected not to make the final payment, in which event the deed to the said property would be returned to the sellers.

The taxpayer erroneously reported on his 1953 U. S. Income Tax Return his share of the yearly payment of $19,000 received in 1953 as rental income and paid tax thereon at ordinary income tax rates.

Under the Federal income tax law, a completed sale occurred in 1946 resulting in a long term capital gain. For further details, the Revenue Agent's Reports and other records and documents on file with the Treasury Department concerning the above taxpayer and involving the taxable years 1946, 1947, 1948, 1949, and 1950, are expressly incorporated herein by reference.

* * * * *

EXHIBIT "K"

LEASE AGREEMENT AND PURCHASE OPTION

This Agreement, made and entered into this 14th day of January, 1946, by and between T. W. Elliot and Evelyn W. Elliot, husband and wife, of Kalispell, Montana, and W. G. Elliot, a widower, of

Exhibit "K"—(Continued)

Kalispell, Montana, parties of the first part, and F. A. Buttrey Company, a Montana corporation, with its principal office at Havre, Montana, the party of the second part,

Witnesseth:

1. That the said parties of the first part, for and in consideration of the rents, covenants and agreements herein mentioned and to be paid and performed by the said party of the second part, its successors and assigns, have demised, leased and let, and by these presents do demise, lease and let unto said party of the second part, its successors and assigns, the following described premises situated in the City of Kalispell, County of Flathead, State of Montana, to wit:

> Lots Eight (8), Nine (9), Ten (10), Eleven (11) and Twelve (12) of Block Fifty-five (55) of the original townsite of Kalispell, Montana, according to the official map or plat thereof on file and of record in the office of the County Clerk and Recorder of said County of Flathead, together with all improvements thereon, subject, however, to all lease-hold interests of each and all of the tenants now occupying said premises, or any portion thereof.
>
> Also Lots Five (5) and Six (6) of Block Seventy-Four (74) of said original townsite of Kalispell, Montana.

To Have and To Hold the above described property unto the party of the second part, for and dur-

Exhibit "K"—(Continued)

ing the full term of ten (10) years beginning with the 1st day of February, 1946, and ending on the 31st day of January, 1956.

2. The party of the second part for itself, its successors and assigns, promises and agrees to pay to said first parties, their heirs, executors, administrators, or assigns, as rent for the above described property, the sum of Nineteen Thousand and No/100 Dollars ($19,000.00) per lease year, payable in cash in advance, the first year's rent to be paid at the time of the execution of this agreement, the receipt whereof is hereby acknowledged by the first parties, and that the rent for each succeeding year during the term of this lease shall be paid by said second party on or before the first day of February of each year hereafter, and during the full period covered by this agreement.

3. It is expressly understood and agreed by and between the parties hereto that the party of the second part has viewed said premises and accepts them in their present condition, and that said second party will, at its own expense, keep said improvements in good repair during the term of this lease; and the party of the second part further covenants and agrees not to commit nor suffer any waste to be committed upon said premises, and that unless the option of purchase herein granted to the party of the second part is exercised as herein provided, said second party agrees to return said property and premises to the first parties at the end of the lease period herein provided, or the sooner ter-

Exhibit "K"—(Continued)

mination thereof, in as good condition as it now is or may hereafter be put in by the party of the second part, reasonable wear and tear and damage by the elements alone excepted.

4. The party of the second part further covenants and agrees at its own expense to keep the buildings and improvements upon the premises above described insured against damage or loss by fire at their full insurable value, but in no event for a sum less than $175,000.00, and to pay all premiums on any and all policies issued thereon as such premiums become due, which policies shall provide that all loss, if any, thereunder, shall be payable to the parties of the first part as their interests may appear, provided, however, that in the event of a total loss, the maturity of this contract may be accelerated at the option of the party of the second part, and said second party may thereupon elect to exercise the option herein given to purchase said premises by the payment of the amount provided in the purchase option hereinafter given, to wit: $75,000.00, as therein provided, and the said second part shall in addition thereto, and in addition to the rentals then paid hereunder, pay all of the remaining rental for the full ten year period of this lease, less the amount actually paid to said first parties under said insurance policies for the loss sustained thereunder.

5. It is further understood and agreed that the party of the second part shall take over all insurance now being carried upon said premises and

Exhibit "K"—(Continued)

agrees that at the time of the taking of possession of said premises hereunder, the second party will pay to the first parties all unearned portions of the premiums heretofore paid by said first parties for all of said insurance computed as of February 1st, 1946.

6. As further consideration of this agreement, the party of the second part shall and hereby agrees to pay all State, County and City taxes levied or assessed against all of the property above described and against any and all improvements thereon, whether in existence or hereafter made thereon, during the term of this lease. The party of the second part further agrees at its own cost and expense to fully maintain said property and furnish all fuel, light, power and water in connection with the use and occupancy thereof.

7. The party of the second part shall have and is hereby given the right to assign or transfer this lease and to sub-let said premises, or any part thereof, during the term of this lease agreement, and said second party shall have the right and it shall be its duty to collect any and all rentals from any and all sub-lessees and sub-tenants of said premises during said lease period, and all rentals collected by said second party upon said premises, or any part thereof, during the period of this lease, from and after January 31st, 1946, shall be paid to and be deemed the property of the party of the second part. In other words, it is expressly under-

Exhibit "K"—(Continued)

stood and agreed by and between the parties hereto that all advance rentals due on and after February 1st, 1946, shall, during the continuance of this agreement, be collected and retained by the second party herein; that all back rentals and rentals which have accrued, but remain unpaid as of January 31st, 1946, shall belong to and be collected by the parties of the first part; and that all advance rentals paid prior to February 1st, 1946, shall be adjusted between the parties as of February 1st, 1946, when possession of said premises is delivered to said second party.

8. It is further understood and agreed by and between the parties hereto that the party of the second part shall have the right to make alterations and improvements in and upon said premises during the term of this lease agreement, except that before any major improvements or remodeling is done in or upon the building situated on said premises, the consent in writing of the first parties shall be obtained therefor. It is further understood and agreed that any fixtures or improvement or any movable material which may be placed in or upon said premises by the second party during the term of this lease, may, at the option of said second party, be removed from said premises upon the expiration of this lease, or the sooner termination thereof, provided such removal may be accomplished without unreasonable injury or damage to the buildings upon said premises and that any damage done is repaired or replaced by said second party.

Exhibit "K"—(Continued)

9. The parties of the first part covenants and agrees with the second party that if said second party shall pay the rents and perform the covenants, agreements and conditions on its part as herein provided, it shall have, hold and enjoy the quiet and peaceful possession of said demised premises during the full term of this lease.

10. It is further understood and agreed that in the event of damage to said premises by fire which shall render said premises untenantable, and the second party desires to restore said premises to tenantable condition, the insurance benefits herein provided for shall be released and paid to said second party and used by it for the restoration of said premises. In the event of any damage to said premises by fire or otherwise, the party of the second part agrees to promptly notify the first parties in order that said first parties may enter in and upon said premises to investigate the loss and the cost of repairs and replacements thereof. But if the damage be such that the second party does not elect to, and does not in fact repair or reconstruct the premises within a period of six months after the occurance of such damage, then, this lease shall be deemed terminated as of the end of said six month period, unless the party of the second part shall have exercised its option of purchase under the acceleration clause herein as provided in paragraph 4 hereof.

11. The party of the second part hereby further

Exhibit "K"—(Continued)

expressly agrees that during the term of this lease it will faithfully comply with all sanitary regulations of the State of Montana, and the ordinances of the City of Kalispell including, but without limitation, the requirement to keep the sidewalks adjoining said premises free and clear of snow and ice and to otherwise comply with the City ordinances and the laws of the State of Montana applicable to the ownership and occupancy of said premises. It is, however, expressly understood and agreed by and between the parties hereto that in the event it becomes necessary to make any basic structural improvements to said building by reason of and under order of public authority, the expenses of such improvement upon said building on said premises shall be borne by the parties of the first part, but it is expressly understood and agreed that this burden shall be limited to only such structural improvements as are ordered by public authority.

12. As further consideration for this agreement, the party of the second part shall have and is hereby given the right and option to purchase said leased premises and property above described for the sum of Seventy-five Thousand and No/100 Dollars ($75,000.00) at any time during the three month period beginning with November 1st, 1955 and ending with January 31st, 1956. It is mutually understood and agreed by the parties hereto that said option of purchase can only be exercised during the three month period immediately above specified except under the acceleration provisions in

Exhibit "K"—(Continued)

paragraph 4 herein, and that said option may be exercised by said second party by giving either of said first parties notice in writing of said second party's intention to exercise said option, and by depositing with the Conrad National Bank of Kalispell at Kalispell, Montana, the said sum of $75,000.00 to the credit of said first parties. It is understood and agreed, however, that in lieu of such personal service of notice of intention to exercise said option, such notice may be sent by registered mail addressed to either of the first parties at Kalispell, Montana, and that the date of depositing such notice by registered mail at Kalispell, Montana, addressed to either of said first parties, and the depositing of such funds in said bank, shall be deemed the date of the exercise of said option.

13. It is further understood and agreed by and between the parties hereto that at the time of the execution of this agreement, the parties of the first part shall likewise execute a good and sufficient Warranty Deed conveying the property hereinabove described to said second party, free and clear of liens and encumbrances, which deed, together with a copy of this agreement, shall be deposited in escrow with said Conrad National Bank of Kalispell with instructions to said Bank that said deed be delivered to the second party only if and when said second party exercises its option of purchase hereunder in keeping with the terms and conditions herein set forth. The parties of the first part covenant and agree that they are seized and pos-

Exhibit "K"—(Continued)

sessed of title in fee to said premises and that they will furnish an Abstract of Title covering the real estate above described, prepared and certified to by a duly licensed abstractor in and for the State of Montana, which Abstract of Title shall be delivered to Messrs. Walchli and Korn, attorneys at law, Kalispell, Montana, on or before February 1st, 1946, for the purpose of examination of said title by said attorneys, with the understanding that upon the completion of said examination, said Abstract of Title shall be returned by said attorneys to said Bank and shall thereafter be held by it in escrow with said deed and a copy of this contract, as hereinabove provided. It is understood and agreed that in the event the party of the second part shall fail to exercise said option of purchase as and within the time hereinabove specified, the said Conrad National Bank as such escrow agent shall have the right, and is hereby given the authority, to return said deed and abstract to the first parties, or either of them. It is further understood and agreed that if upon the examination of said abstract of title, it appears that the title is defective, but that such defect can be remedied, then, and in such event, the parties of the first part agree to immediately undertake and diligently prosecute the correction of any such defect at their expense. It is further agreed that any and all charges the said Conrad National Bank shall make as such escrow agent for its services hereunder shall be borne and paid for by the party of the second part.

Exhibit "K"—(Continued)

14. It is further understood and agreed that in the event the party of the second part shall vacate said premises or abandon the same during the term of this lease agreement, the parties of the first part may, at their option and without terminating this lease, enter into and upon said premises and remove the second party's signs therefrom and re-let the same for the account and benefit of said second party for such rent and upon such terms as shall be agreeable to said second party, without such re-entry working a waiver of or a forfeiture of the rents to be paid and the covenants to be performed by said second party during the full term of this lease agreement as herein provided, but it is understood and agreed that the first parties shall not be under any obligation to so enter said premises and sub-let the same. In the event the first parties shall exercise their option to re-enter said premises and sub-let the same as in this paragraph above provided, the first parties are hereby expressly authorized to make any and all repairs, changes, alterations and additions in or to said demised premises that the first parties may deem necessary and convenient to the use of said property, and if a sufficient sum is not realized from such re-letting of said premises by said first parties after paying all of the costs and expense of such repairs, changes, alterations or additions, plus the expense of such re-letting and the collection of the rent accruing therefrom, the first parties shall apply the rent so collected as a credit upon any and all rental due or

Exhibit "K"—(Continued)

to become due to said first parties under the terms of this lease, and the party of the second part hereby expressly covenants and agrees to pay to said first parties at the end of any lease year, any deficiency in rental which may exist by reason of such handling of said property, by the first parties.

15. It is further mutually understood and agreed by and between the parties hereto that all of the covenants and agreements herein contained are and shall be binding upon the heirs, personal representatives, successors and assigns of the respective parties hereto.

In Witness Whereof the first parties have hereunto set their hands and seals, and the second party has hereunto caused its corporate name to be subscribed and its seal affixed by its proper officers thereunto duly authorized.

[Seal] /s/ T. W. ELLIOT,
[Seal] /s/ EVELYN W. ELLIOT,
[Seal] /s/ W. G. ELLIOT,
First Parties.

F. A. BUTTREY COMPANY,
a Corporation,
/s/ By G. O. OMLIE,
Vice-President,
Second Party.

Attest:
/s/ A. C. OLSON,
Secretary.

Exhibit "K"—(Continued)

State of Montana,
County of Flathead—ss.

On this 14th day of January, 1946, before me, Daniel J. Korn, a Notary Public for the State aforesaid, personally appeared T. W. Elliot and Evelyn W. Elliot, husband and wife, and W. G. Elliot, known to me to be the persons who executed the foregoing instrument as First Parties, and acknowledged to me that they executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my Notarial Seal the day and year first above written.

/s/ DANIEL J. KORN,

Notary Public for the State of Montana residing at Kalispell, Montana. My Commission expires Sept. 22, 1946.

State of Montana,
County of Flathead—ss.

On this 14th day of January, 1946, before me, Daniel J. Korn, a Notary Public for the State aforesaid, personally appeared G. O. Omlie, known to me to be the Vice-President of F. A. Buttrey Company, the corporation that executed the foregoing instrument as Second Party, and acknowledged to me that such corporation executed the same.

In Witness Whereof, I have hereunto set my

Exhibit "K"—(Continued)

hand and affixed my Notarial Seal the day and year first above written.

/s/ DANIEL J. KORN,

Notary Public for the State of Montana residing at Kalispell, Montana. My Commission expires Sept. 22, 1946.

EXHIBIT "L"

MEMORANDUM AGREEMENT

This Agreement, made and entered into this 1st day of February, 1946, by and between T. W. Elliot and Evelyn W. Elliot, husband and wife, of Kalispell, Montana, and W. G. Elliot, a widower, of Kalispell, Montana, parties of the first part, and F. A. Buttrey Company, a Montana corporation, with its principal office at Havre, Montana, the party of the second part,

Witnesseth:

That Whereas, the parties hereto have heretofore on the 14th day of January, 1946, entered into a written Lease Agreement covering Lots 8, 9, 10, 11 and 12 of Block 55 of the original townsite of Kalispell, Montana, commonly known as the Buffalo Block; and also covering Lots 5 and 6 of Block 74 of said original townsite of Kalispell, the term of which Lease Agreement begins February 1, 1946 and ends on the 31st day of January, 1956, and

Whereas, said Lease Agreement grants the above

Exhibit "L"—(Continued)

named second party the right and option to purchase all of the above described property for a stated consideration, provided such option is exercised by said second party on or between November 1, 1955 and January 31, 1956, and

Whereas, each of said parties has a duly executed copy of said Lease Agreement and Option,

Now Therefore, it is mutually understood and agreed that the first parties shall, in contemplation of the exercise of said option by said second party, immediately deliver to the Conrad National Bank of Kalispell, Montana, the following papers:

1. An executed Warranty Deed conveying the above described property to the second party;

2. An abstract of title covering said property showing said first parties to be vested with a merchantable title, free and clear of encumbrances, as of the date of said Lease and Option Agreement, January 14, 1946;

the foregoing instrument to be held by said Bank in escrow and to be delivered by said Bank to the second party if and when said Option of Purchase is exercised in keeping with the terms thereof and proof of full payment by said second party under said Lease Agreement as of the time of the exercise of said option.

In the event said Option of Purchase is not exercised by the second party on or before January 31, 1956, the above mentioned papers shall be returned by said Bank to the first parties, their heirs or assigns.

Exhibit "L"—(Continued)

In Witness Whereof the first parties have hereunto set their hands and seals, and the second party has hereunto caused its corporate name to be subscribed and its seal affixed by its proper officers thereunto duly authorized.

[Seal] /s/ W. G. ELLIOT,
[Seal] /s/ EVELYN W. ELLIOT,
[Seal] /s/ T. W. ELLIOT,
First Parties.

F. A. BUTTREY COMPANY, a corporation,
/s/ By G. O. OMLIE,
Vice-President,
Second Party.

State of Montana,
County of Flathead—ss.

On this 1st day of February, 1946, before me, Daniel J. Korn, a Notary Public for the State aforesaid, personally appeared T. W. Elliot and Evelyn W. Elliot, husband and wife, and W. G. Elliot, known to me to be the persons who executed the foregoing instrument as First Parties, and acknowledge to me that they executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my Notarial Seal the day and year first above written.

/s/ DANIEL J. KORN,
Notary Public for the State of Montana. Residing at Kalispell, Montana. My Commission expires Sept. 22, 1946.

Exhibit "L"—(Continued)

State of Montana,
County of Flathead—ss.

On this 1st day of February, 1946, before me, Daniel J. Korn, a Notary Public for the State aforesaid, personally appeared G. O. Omlie, known to me to be the Vice-President of F. A. Buttrey Company, the corporation that executed the foregoing instrument as Second Party, and acknowledged to me that such corporation executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my Notarial Seal the day and year first above written.

/s/ DANIEL J. KORN,
Notary Public for the State of Montana. Residing at Kalispell, Montana. My Commission expires Sept. 22, 1946.

[Endorsed]: Filed May 25, 1955.

[Title of District Court and Cause No. 1727.]

ANSWER

Comes now the defendant, by his attorney of record, Krest Cyr, United States Attorney for the District of Montana, and in answer to plaintiff's complaint herein:

A. Denies every allegation not admitted, qualified or otherwise specifically referred to below.

B. Further answering the petition:

1. Denies the allegations in paragraph 1 except those relating to the provisions of Section 322 of the Internal Revenue Code of 1939 admitted in other numbered paragraphs to follow.

2. Admits the allegations in paragraph 2.

3. Admits the allegations in paragraph 3.

4. Denies the allegations in paragraph 4.

5. Admits the allegations in paragraph 5.

6. Admits the allegations in the first sentence of paragraph 6 and alleges that the claim was filed on March 10, 1951. Admits the allegations in the second sentence of paragraph 6 except to deny that Exhibit "A" is a complete copy of the original claim and also to deny all allegations in the claim for refund not elsewhere herein admitted.

7. Admits the allegations in paragraph 7.

8. Admits the allegations in paragraph 8 except to deny that Exhibit "B" is a complete copy of the original claim and also to deny all allegations in the claim for refund not elsewhere herein admitted.

9. Admits the allegations in the first and last sentences of paragraph 9 and denies all other allegations in such paragraph.

10. Admits the allegations in paragraph 10 except to deny that Exhibit "C" is a complete copy of the original claim and also to deny all allegations in the claim for refund not elsewhere herein admitted.

11. Admits the allegations in the first sentence of paragraph 11, denies the allegations in the second

sentence, and also admits the allegations in the third sentence except to allege that the interest payment was only $114.21.

12. Denies the allegations in paragraph 12 except to admit that a claim for refund of $940.30 was filed on March 10, 1951; to admit that another claim for refund of $2,454.60 was filed on March 15, 1953; to deny that Exhibits "D" and "E" are complete copies of the original claims; and to deny all allegations in such claims not elsewhere herein admitted.

13. Admits the allegations in paragraph 13 except to allege that the plaintiff paid only $3,148.71 of the sum of $3,281.31 and also paid only $12.90 as interest assessed on the deficiency; and to allege that payments aggregating $3,148.71 were made in the amounts of $582.15 on March 15, 1950, of $1,746.45 on September 19, 1950, and of $820.11 on March 15, 1951.

14. Denies the allegations in paragraph 14 except to admit that a claim for refund of $1,525.48 was filed on March 10, 1951 and disallowed with statutory notice on April 22, 1954; to admit that another claim for refund of $3,360.45 was filed on March 15, 1954; to admit that Exhibits "F" and "G" are true but incomplete copies of such claims; and specifically denies all allegations in paragraph 14 and in such refund claims as are not elsewhere herein admitted.

15. Admits the allegations in the first sentence of paragraph 15 and denies the allegations in the second sentence thereof except to admit that the

plaintiff paid $2,000 before March 15, 1952, and also paid $1,710.23 on September 17, 1952.

16. Admits the allegations in paragraph 16 except to deny that Exhibit "H" is a complete copy of the original claim and also to deny all allegations in the claim for refund not elsewhere herein admitted.

17. Admits the allegations in the first sentence of paragraph 17 and denies the allegations in the second sentence thereof except to admit that the plaintiff paid $3,000 on or before March 15, 1953.

18. Admits the allegations in paragraph 18 except to deny that Exhibit "I" is a complete copy of the original claim and also to deny all allegations in the claim for refund not elsewhere herein admitted.

19. Admits the allegations in paragraph 19 but alleges that a portion of the amount paid was credited to the tax due upon plaintiff's 1954 return, leaving a net payment of only $4,010.10.

20. Admits the allegations in paragraph 20 except to deny that Exhibit "J" is a complete copy of the original claim and also to deny all allegations in the claim for refund not elsewhere herein admitted.

21. Admits the allegations in the first sentence of paragraph 21 and denies the allegations in the second sentence of such paragraph.

22. Denies the allegations in the first sentence of paragraph 22 and is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations in paragraph 22.

23. Denies the allegations in paragraph 23 except to admit that the plaintiff received an amount of $10,000 in 1946.

24. Denies the allegations in paragraph 24.

25. Denies the allegations in paragraph 25.

26. Denies the allegations in paragraph 26 except to admit that the plaintiff in 1947 received $10,000.

27. Denies the allegations in paragraph 27.

28. Denies the allegations in paragraph 28 except to admit that the plaintiff in 1948 received $10,000.

29. Denies the allegations in paragraph 29.

30. Denies the allegations in paragraph 30 except to admit that the plaintiff in 1948 received $10,000.

31. Denies the allegations in paragraph 31.

32. Denies the allegations in paragraph 32 except to admit that the plaintiff in 1950 received $10,000.

33. Denies the allegations in paragraph 33.

34. Admits the allegations in paragraph 34 and also alleges that the 1951, 1952 and 1953 claims for refund were disallowed with statutory notice dated July 5, 1955.

35. Denies the allegations in paragraph 35 except to admit that the plaintiff in each of the years 1951, 1952 and 1953 received $10,000.

36. Denies the allegations in paragraph 36 except to admit that no part of the amounts therein set forth have been refunded or credited.

Affirmative Defense

37. The plaintiff's individual federal income tax return for the calendar year 1946 was filed and his payments for the tax reported thereon were made on or before March 15, 1947. Later, on March 10, 1951, he filed a claim for refund of $1,041.97 of the tax so paid. Such claim for refund was not filed within three years from the time the return was filed or within two years from the time the tax was paid, as required by applicable provisions in Section 322(b) of the Internal Revenue Code of 1939. The Court has no jurisdiction except to dismiss the pending action in so far as it relates to plaintiff's asserted claim for the calendar year 1946.

38. The Court is requested to order a reply to the affirmative defense in paragraph 37 of this answer, as provided in Rule 7(a).

Wherefore, defendant demands judgment that plaintiff's complaint be dismissed, together with the costs of this action.

KREST CYR,
United States Attorney,
/s/ MICHAEL J. O'CONNELL,
Assistant U. S. Attorney.
Attorneys for the Defendant.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed October 5, 1955.

[Title of District Court and Cause No. 1727.]

AMENDMENT TO COMPLAINT

Plaintiff, by his attorneys, for his amendment to his complaint herein alleges:

1. Paragraph (22) of the Complaint is amended so that, as amended, it shall read exactly as now written with the addition of the following sentence at the end thereof: On or about November 5th, 1955, the above-mentioned F. A. Buttrey Company, elected to make the agreed payment of $75,000.00 and said sum was paid to the plaintiff and to Thomas W. Elliot and his wife, Evelyn W. Elliot.

2. Paragraph (24) of the Complaint is amended by striking out the figure $19,321.63 and replacing it with the figure of $20,321.63.

Dated June 15, 1956.

FELT, FELT, & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiff.

[Endorsed]: Filed June 15, 1956.

In The United States District Court, District of Montana, Billings Division

No. 1727

WILLIAM G. ELLIOT, Plaintiff,

vs.

THOMAS M. ROBINSON, Defendant.

No. 1728

THOMAS W. ELLIOT and EVELYN W. ELLIOT, Plaintiffs,

vs.

THOMAS M. ROBINSON, Defendant.

CONSOLIDATION FOR TRIAL

The above entitled cases are hereby consolidated for trial.

Dated, June 15, 1956.

FELT, FELT, & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiffs.

KREST CYR,
U. S. Attorney,
/s/ By DALE F. GALLES,
Attorney for Defendant.

[Endorsed]: Filed June 15, 1956.

[Title of District Court and Cause Nos. 1727-1728.]

STIPULATION OF DOCUMENTARY EVIDENCE

The following documents are stipulated as evidence in these cases:

Copy of "Lease Agreement and Purchase Option" which is attached to the complaints.

Copy of "Memorandum Agreement" which is attached to the complaints.

Copy of "Affidavit and Statement By Seller to Purchase Under Bulk Sales Law" which is attached to the complaint in Case No. 1728.

Dated June 15, 1956.

FELT, FELT, & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiffs.

KREST CYR,
U. S. Attorney,
/s/ By DALE F. GALLES,
Attorneys for Defendant.

[Endorsed]: Filed June 15, 1956.

[Title of District Court and Cause No. 1727.]

STIPULATION OF FACTS

1. This action is instituted pursuant to the provisions of Section 322 of the Internal Revenue

Code of 1939 (U.S.C Title 26, Sec. 322) for the recovery of Federal income taxes and interest thereon, paid for the calendar years 1946, 1947, 1948, 1949, 1950, 1951, 1952, and 1953.

2. The plaintiff is an individual, residing at the Northern Hotel, Billings, Montana, and is a resident of the District of Montana.

3. This action against Thomas M. Robinson, U. S. District Director of Internal Revenue, arises under the Act of June 25, 1948, 62 Stat. 932, United States Code, Title 28, Sec. 1340.

4. The plaintiff duly filed his Federal income tax return for the calendar year 1946 with the above-named defendant. The plaintiff paid, on or before March 15, 1947, the amount of $1,985.67, the Federal income tax for 1946 shown to be due by said return.

5. The plaintiff filed with the defendant a claim for refund of $1,041.97 income tax paid for the year 1946. A true copy of said claim for refund is attached to the complaint and marked Exhibit "A", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case. Said claim for refund was filed on March 10, 1951 and therefore was not filed within the time limit required by Section 322(b) of the 1939 Internal Revenue Code.

6. The plaintiff duly filed his Federal income tax return for the calendar year 1947 with the above named defendant. The plaintiff paid on or

before March 15, 1948, the amount of $2,353.71, the Federal income tax shown to be due by said return. On or about November 16, 1950, pursuant to a notice and demand received from the above-named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1947 in the amount of $342.33, together with interest thereon of $52.30, said payments being made to the above-named defendant.

7. On or before March 15, 1951, the plaintiff duly filed with the defendant a timely claim for refund of $1,376.81, income tax paid for the year 1947. A true copy of said claim for refund is attached to the complaint and marked Exhibit "B", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

8. The plaintiff duly filed his Federal income tax return for the calendar year 1948 with the above-named defendant. The plaintiff paid the amount of $2,089.30. On or about November 16, 1950, pursuant to a notice and demand received from the above-named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1948 in the amount of $1,056.44, together with interest thereon of $98.03, said payments being made to the above-named defendant.

9. On or before March 15, 1952, the plaintiff duly filed with the defendant a timely claim for refund of $1,527.52, income tax paid for the year 1948. A true copy of said claim for refund is

attached to the complaint and marked Exhibit "C", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

10. The plaintiff duly filed his Federal income tax return for the calendar year 1949 with the above-named defendant. The plaintiff paid on or before March 15, 1950, the amount of $2,454.60, the Federal income tax shown to be due by said return. During the calendar year 1953 and pursuant to a notice and demand received from the above-named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1949 in the amount of $512.30, together with interest of $114.21, said payments being made to the above-named defendant.

11. On or before March 15, 1953, the plaintiff duly filed with the defendant a timely claim for refund of $940.30, income tax paid for the year 1949. A true copy of said claim for refund is attached to the Complaint and marked Exhibit "D", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case. On or about March 15, 1953, the plaintiff duly filed with the defendant another timely claim for refund of $2,454.60 or such other amount as is legally refundable, plus interest, for the year 1949. A true copy of said claim for refund is attached to the Complaint and marked Exhibit "E", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

12. The plaintiff duly filed his Federal income tax return for the calendar year 1950 with the above-named defendant. The plaintiff paid on or before March 15, 1951, the amount of $3,281.31, the Federal income tax shown to be due by said return. During the calendar year 1953 and pursuant to a notice and demand received from the above-named defendant, the plaintiff paid a deficiency in income tax for the calendar year 1950 in the amount of $79.14, together with interest thereon of $12.90, said payment being made to the above-named defendant.

13. On or before March 15, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $1,525.48, income tax paid for the year 1950. A true copy of said claim for refund is attached to the Complaint and marked Exhibit "F", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case. On or before March 15, 1954, the plaintiff duly filed with the defendant another timely claim for refund of $3,360.45 or such other amount as is legally refundable, plus interest, for the taxable year 1950. A true copy of said claim for refund is attached to the Complaint and marked Exhibit "G", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

14. The plaintiff duly filed his Federal income tax return for the calendar year 1951 with the above-named defendant. The plaintiff paid, on or

before March 15, 1952, the amount of $2,155.20 and paid $1,710.23 principal and $51.31 interest on September 17, 1952, pursuant to extension of time granted, making a total tax paid of $3,865.43, the Federal income tax shown to be due by said return.

15. On or about July 8, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $3,865.43, income tax paid for the year 1951. A true copy of said claim is attached to the Complaint and marked Exhibit "H", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

16. The plaintiff duly filed his Federal income tax return for the calendar year 1952 with the above-named defendant. The plaintiff paid on or before March 15, 1953, the amount of $3,169.20, paid $1,000 on April 9, 1953, and $146.19 principal and $4.02 interest on September 2, 1953, making a total tax paid of $4,315.39, the Federal income tax shown to be due by said return.

17. On or about July 8, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $4,315.39, income tax paid for the year 1952. A true copy of said claim is attached to the Complaint and marked Exhibit "I", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

18. The plaintiff duly filed his Federal income

tax return for the calendar year 1953 with the above-named defendant. The plaintiff paid, on or before March 15, 1954, the amount of $4,179.30, the Federal income tax shown to be due by said return.

19. On or about July 8, 1954, the plaintiff duly filed with the defendant a timely claim for refund of $4,179.30, income tax paid for the year 1953. A true copy of said claim is attached to the Complaint and marked Exhibit "J", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

20. The plaintiff received $10,000 in each of the years 1946, 1947, 1948, 1949, 1950, 1951, 1952, and 1953 under the "Lease Agreement and Purchase Option". Said amounts were reported and taxed as ordinary rental income in the plaintiff's Federal income tax returns for the years 1950, 1951, 1952, and 1953 and as partnership income in the previous years.

21. Prior to entering into the "Lease Agreement and Purchase Option", the plaintiff owned an undivided one-half interest in the property described therein. Said property had been held by the plaintiff for more than six months. The plaintiff's adjusted basis for determining gain under the Internal Revenue Code of 1939 with respect to said property was $20,321.63 on January 14, 1946.

22. The Commissioner of Internal Revenue dis-

allowed the claims for refund for 1946, 1947, 1948, 1949, 1950, 1951, 1952, and 1953. The complaint in this case was filed within two years of the time of the receipt of all of the statutory disallowances of the aforesaid refund claims. However, as to the year 1946, see paragraph No. 5 above.

23. If the Court holds that the "Lease Agreement and Purchase Option" constitutes, for Federal income tax purposes, a sale or a conditional sale, then in order to conserve the time of the Court it is further stipulated that the parties will submit computations of amounts of over-payment to be entered for the respective years as judgment for plaintiff, and if the computations submitted by the parties differ in amount, the parties shall be afforded an opportunity to be heard in an argument on the date fixed by the Court and thereafter the Court will then determine the correct overpayment and enter its decision.

It is understood and agreed that any argument as to the correct computation of any overpayment shall be strictly confined to the consideration of the correct computation and shall not be used for the purpose of affording an opportunity for rehearing or reconsideration.

24. If the Court holds that the "Lease Agreement and Purchase Option" does not constitute, for Federal income tax purposes, a sale or a conditional sale, then it is further stipulated that the defendant is entitled to a judgment that the plain-

tiff's complaint be dismissed, together with the costs of the action.

Dated June 15, 1956.

FELT, FELT, & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiff.

KREST CYR,
U. S. Attorney,
/s/ By JOHN H. REES,
Attorneys for Defendant.

[Endorsed]: Filed June 15, 1956.

[Title of District Court and Cause Nos. 1727-1728.]

OPINION

Both of the above entitled actions were brought for the recovery of Federal income taxes and interest paid for the taxable years 1946 to 1953, inclusive, and were consolidated for trial.

These actions are based upon the act of June 25, 1948, 62 Stat. 932, U.S.C., title 28, Sec. 1340 (stipulation of facts by the respective parties Par. 3.)

The sole issue herein, as claimed by the plaintiffs, is stated as follows:

"Does the so-called 'Lease Agreement and Purchase Option' constitute a conditional sales agreement for Federal income tax purposes resulting in the payments made thereunder being subject to capital gain tax treatment? Or, stated another

way, is the agreement to be treated as a true lease for Federal income tax purposes resulting in the yearly payments made thereunder being classified as rental income subject to ordinary income tax treatment"?

It also appears that facts relating to jurisdiction and to the amount of tax which the plaintiffs have paid during the years in question are agreed to in the stipulation of facts, and further, in paragraph 23 thereof, it appears that:

"the parties agreed that if the Court holds that the 'lease agreement and purchase option' constitutes, for Federal income tax purposes, a sale or a conditional sale, then, in order to conserve the time of the Court, the parties will submit computations of amounts of overpayments to be entered for the respective years as judgments for the plaintiffs, and if the computations by the parties differ in amount, the parties shall be afforded an opportunity to be heard in argument on the date fixed by the Court, and thereafter the Court will then determine the correct overpayment and enter its decision."

At the outset the plaintiffs assert that they have established by competent proof that the so-called "Lease Agreement and Purchase Option" constitutes a conditional sales agreement for Federal income tax purposes.

But the defendant has also raised questions that require consideration in connection with the claims

of plaintiffs, such as, whether in Civil No. 1727 the Court has jurisdiction to enter judgment in favor of plaintiffs therein upon claims for refund filed March 19, 1951, for the year 1946, and upon other claims for refund that were timely filed for 1950, 1951, 1952 and 1953; whether in No. 1728, the Court has jurisdiction to enter a judgment in favor of plaintiffs therein upon refund claims which they timely filed in 1946, 1947, 1950, 1951, 1952, and 1953; whether under the language in the instrument "Lease Agreement and Purchase Option" executed January 14, 1946, and in a "memorandum agreement" executed later, certain payments received annually by the tax payers ($10,000. in No. 1727, and $9,000. in No. 1728) were made for the use and occupancy of their business property and properly reported by them for Federal income tax purposes as ordinary rental income upon returns which they voluntarily filed with the District Director for the calendar years 1946 through 1953; whether, if such annual payments were installment payments of the purchase price of realty sold in 1946 by the tax payers, as now claimed, and admitted gain was taxable either in 1946 or in installments, there are any overpayments by the tax payers not now barred from recovery by established principles of equity and good conscience applicable under the facts of record in each of the pending actions.

There seems to be no question that the plaintiffs have the burden of proof, and in a considera-

tion of the merits the issue is principally one of fact, and the question constantly arises in litigation of this nature whether the evidence shows conclusively from an equitable standpoint that the plantiffs are entitled to a refund of money illegally withheld by the defendant. The parties in interest were all present when the agreement in question was signed, which was accepted by them without change, all apparently having a full understanding of the purport and legal effect of the agreement, which together with the intent of the parties in executing it would unquestionably under the rule relied upon be controlling. The payments made each year under the agreement from 1946 to 1953 by the Buttrey Co. were received by the plaintiffs and reported in their income tax returns as rental income. But in that connection it has been held that the Court will construe the agreement from its own independent judgment and is not bound by the name attached to it or an erroneous construction placed upon it. In Watson v. Commissioner, 62 F(2) 35 (9th Cir. 1932) the Court said:

"We have approached the construction of this agreement under the rule recognized by the Supreme Court in Heryford v. Davis, 102 U.S. 235, 244, where the Court said: '* * * (it) is not to be found in any name which the parties may have given to the instrument, and not alone in any particular provision it contains, disconnected from all others, but in the ruling intention of the par-

ties, gathered from all the language they have used. It is the legal effect of the whole which is to be sought for. The form of the instrument is of little account.' "

The Court held that the rentals so called, were not intended as rent, but were payments on account of the purchase price.

Among many other cases cited appears that of Oesterreich v. Commissioner, 226 F.(2) 798 (9th Cir. 1955) where the Court said that if the parties enter into a transaction which they honestly believe to be a lease, but which actually has all the elements of a contract of sale, it is a contract of sale regardless of what they call it. The Court cited section 23 (a) (1) (A) of the Internal Revenue Code of 1939, and said that if the lessee is either taking title to the property or has acquired an equity, it cannot treat the payments as rental expense.

The Court has gone over the evidence and authorities cited, and arguments made by counsel for the respective parties, in the voluminous briefs submitted, and after careful consideration thereof, is now ready to determine that it has been conclusively established that the Elliot brothers made a sale of their property to the Buttrey Company, and that it was so understood by both parties, and that the monthly rentals, so called, were installment payments on the purchase price, and that such is the construction to be placed upon the agreements here in question, and that they should

be treated accordingly for income tax purposes, and that proper refunds, to be determined later, should be made. Under the evidence the greater weight of authority seems to hold that the parties here intended to enter into an agreement for the sale of the property described therein.

William G. Elliot and Thomas W. Elliot, plaintiffs therein, had been the owners and operators of the Flathead Commercial Co. and the Buffalo block, a business property, situated in Kalispell, Montana, for many years, and they had decided to sell their property, and all of it, to the Buttrey Co., chiefly because of failing health, and for that purpose the parties, on January 14, 1946, entered into the "Lease Agreement and Purchase Option" and on February 1, 1946, executed the supplemental contract, known as "Memorandum Agreement." Buttrey Co., through their attorneys, prepared the agreement, and the Elliot Brothers, not represented by counsel, accepted and signed the agreements as prepared by counsel for Buttrey Co. It appears in evidence that the Elliot Brothers were unfamiliar with tax matters, and also with technical sales agreements, they relied upon Buttrey Co.'s counsel; they were simply selling their property and all of it.

On November 5, 1955, Buttrey Co. received from the escrow agent, upon final payment of the full purchase price, the deed, abstract of title and title opinion as of January 14, 1946. And, as it appears, the terms of the agreement had been per-

formed precisely as written therein, and the sale, as intended by the parties, was fully consummated. As stated by counsel:

"The comparison between the plaintiffs net rental income of some $5,000. a year prior to entering into this agreement and their net 'rental' income of $19,000. after the agreement was signed is further evidence that the $19,000. payments were not true rent payments for the use of this property."

The Court does not deem it necessary to go into all the details of evidence and arguments of counsel, or citation of authorities; the Court is convinced from its own examination and consideration thereof that the plaintiffs are entitled to a ruling in their favor, and such is the Order and decision of the Court herein.

Appropriate findings of fact and conclusions of law may be submitted accordingly, also form of judgment. The Court will again call the attention of counsel for the respective parties herein to the stipulation of facts in said cause, and especially to paragraph 23 therein.

Exception allowed Counsel.

/s/ CHARLES N. PRAY,
Judge.

[Endorsed]: Filed June 27, 1957.

[Title of District Court and Cause No. 1727.]

NOTICE OF APPEAL

Notice is hereby given that Thomas M. Robinson, the defendant named above, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the decision of Judge Charles N. Pray in an opinion filed June 27, 1957.

KREST CYR,
United States Attorney,

/s/ DALE F. GALLES,
Assistant U. S. Attorney,
Attorneys for Defendant.

[Endorsed]: Filed August 26, 1957.

[Title of District Court and Cause No. 1727.]

ORDER

Pursuant to the Application for Extension of Time of defendant, the United States of America, to perfect and docket the record on appeal herein, and good cause appearing therefor,——

It Is Now Ordered that the time within which the defendant may perfect and docket its appeal herein be, and hereby is, extended for a period of fifty (50) days.

Dated this 4th day of October, 1957.

/s/ W. J. JAMESON,
United States District Judge.

[Endorsed]: Filed Oct. 4, 1957. Entered Oct. 7, 1957.

[Title of District Court and Cause Nos. 1727 and 1728.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Upon the evidence submitted to the Court on the 15th day of June, 1956, and the agreed Stipulation of Facts submitted in the above entitled and numbered causes, which were consolidated for trial, the Court makes the following

Findings of Fact

1. That paragraphs numbered 1 to 22, inclusive, of the Stipulation of Facts, in Civil #1727, and paragraphs numbered 1 to 22, inclusive, of the Stipulation of Facts, as amended, in Civil #1728, and the Stipulation of Documentary Evidence, filed on June 15, 1956 in both actions, are adopted as Findings of Fact of the Court and they are made a part hereof by this reference;

2. That plaintiff's Exhibit No. 1 was stipulated as evidence in both actions and it is adopted as a part of the Findings of Fact of the Court and it is made a part hereof by this reference;

3. That Mr. Thomas Elliot, prior to the year 1946, was an officer and the manager and operator of the Flathead Commercial Company, a corporation, at Kalispell, Montana and that he ran the business of this company which was engaged in the sale of general merchandise and in the operation of a department store and that it had been in business since the 1920's;

4. That during 1945, Mr. Thomas Elliot was approached by the F. A. Buttrey Company (hereinafter called Buttrey Co.), a well-known Montana corporation which operates a number of retail department stores; that said company desired to purchase the business of the Flathead Commercial Company; that Buttrey Co. had previously discussed such a purchase but serious negotiations were not entered into until July or August of 1945; that late in 1945, Mr. Thomas Elliot decided, principally due to reasons of his health, to sell his store business, that is, the business of the Flathead Commercial Company; that negotiations were carried on in Billings in December of 1945 with representatives of Buttrey Co. and Mr. Thomas Elliot's brother, Mr. William Elliot, and his nephew, Mr. Howard Elliot, were also present; that during these negotiations, a final agreement was made for the sale of the goods and business of the Flathead Commercial Company to Buttrey Co. and that, subsequently, Mr. Thomas Elliot, as the President of the Flathead Commercial Company, executed an affidavit and statement as required by the Montana Bulk Sales Law (See Stipulation of Documentary Evidence);

5. That the business of the Flathead Commercial Company was conducted in a building known as the Buffalo Block in Kalispell, Montana;

6. That the Buffalo Block consisted of two stories and a basement and it contained store fronts, brick walls and the usual internal divisions supporting the walls; that the Buffalo Block had a

125-foot frontage on Main Street in Kalispell of which the Flathead Commercial Company occupied a 75-foot frontage thereof on the first floor and in the basement; that the remaining 50-foot frontage on the first floor and basement was occupied by Safeway Stores in 1945 and that the second floor consisted of office space which was rented to various tenants; that Safeway Stores held a lease on the space occupied by them which lease expired in 1947;

7. That the Buffalo Block was owned by Mr. Thomas Elliot and his brother, Mr. William Elliot, each owning an undivided one-half interest; that they had purchased this property in 1923;

8. That the Elliot brothers were engaged as partners in the operation of the Buffalo Block; that the income of the Buffalo Block consisted principally of the rentals from the two stores located on the main floor and that they also collected some rentals from the office space on the second story;

9. That, as shown by Plaintiffs' Exhibit #1, (See Para. 2 above), the total gross income from the various tenants of the Buffalo Block (as indicated in the table on the bottom of the exhibit) averaged approximately $16,500 a year for the ten-year period commencing in 1936 and terminating at the end of 1945, that is, just prior to the execution of the so-called "Lease Agreement and Purchase Option" on January 14, 1946; that the expense of operating the Buffalo Block averaged

approximately $9,500 a year and, as shown on the table at the top of the exhibit, such expense consisted of taxes, heat, office expense, repair, wages, light, water, insurance, and general expense and that, in addition, depreciation in the approximate amount of $2,000 was incurred; that the average annual net income was, therefore, approximately $5,000;

10. That during the negotiations with Buttrey Co. concerning the sale of the Flathead Commercial Company, there was no discussion regarding the purchase of the Buffalo Block but it was agreed at that time that Buttrey Co. would be allowed to take over the space then occupied by the Flathead Commercial Company; that Buttrey Co. offered to lease such space at $775 a month for 15 years provided they were given the option to lease the space then occupied by Safeway Stores at $425.35 a month at the expiration of Safeway Store's lease in 1947 or sooner should Safeway Stores vacate the premises; that these negotiations took place in Billings, Montana during December of 1945 but that no agreement was made at that time;

11. That, subsequent to January 1, 1946, the plaintiffs were again approached regarding the disposition of the Buffalo Block and these negotiations took place in Kalispell, Montana; that on January 14, 1946, in the law office of the attorneys representing Buttrey Co., the so-called "Lease Agreement and Purchase Option" was executed

and that on February 1, 1946, the supplemental "Memorandum Agreement" was executed; that the said agreements were prepared by the attorneys for Buttrey Co. and that the plaintiffs were not represented by any lawyer and they paid no legal fees in this matter; that the Elliot brothers were unfamiliar with tax matters, and also with technical sales agreements and that they relied upon Buttrey Co.'s attorneys; that they were simply selling their property and all of it;

12. That the above referred to agreements specified that an abstract of title, together with a title opinion and a warranty deed, wherein the plaintiffs conveyed the property to Buttrey Co., were to be placed in escrow in the Conrad National Bank at Kalispell, and this was done; that the agreements stated that the abstract of title, title opinion, and the warranty deed were to be delivered to Buttrey Co. by said bank provided that full payment was made therefor.

13. That after the execution of the agreements, the plaintiffs vacated the premises and subsequent to that time they did not pay any expenses in connection with the Buffalo Block, including real estate taxes or repairs, nor did they collect any rentals from any of the tenants of the building; that the plaintiffs completely terminated their relation with the management and control of the building, except to make sure that the insurance was kept up; That in Paragraph 4 of the agreement, it is provided that fire insurance in the

amount of at least $175,000 be maintained by Buttrey Co. and that Buttrey Co. later increased the amount of insurance on the building, without being requested to do so by the plaintiffs, to the sum of $250,000;

14. That the fair market value of the property known as the Buffalo Block on January 14, 1946 was approximately $200,000.

15. That it was intended that Buttrey Co. would make the final $75,000 payment referred to in the agreement and that a provision of the "Memorandum Agreement" provided that the parties contemplated the making of this payment and that it was, in fact, made on November 5, 1955; that the agreements were completely performed on that date, that is, the plaintiffs had received all of the payments provided for therein and Buttrey Co. received the deed, abstract, and title opinion from the escrowee; that the terms of the agreement had been performed precisely as written therein and were fully consummated and that the agreements constituted a sales agreement and were intended as such by the parties;

16. That it has been conclusively established that the Elliot brothers did, in fact, make a sale of their property to Buttrey Co. and that it was so understood by both parties, and that the yearly rentals, so called, were installment payments on the purchase price, and that such is the construction to be placed upon the agreements in question,

and that they should be treated accordingly for Federal income tax purposes.

17. That the parties hereto, by their respective counsel, have entered into a stipulation regarding the amounts of overpayments wherein the parties agree, that for the purpose of these actions, the correct amounts of overpayments are deemed to be as follows:

Civil #1727
Overpayments

Year	Tax	Interest	Total
1946	$ —0—	$ —0—	$ —0—
1947	3,110.39	52.30	3,162.69
1948	1,431.59	98.03	1,529.62
1949	1,323.43	114.21	1,437.64
1950	1,436.66	12.90	1,449.56
1951	1,628.40		1,628.40
1952	1,790.66	7.96	1,798.62
1953	1,762.31		1,762.31

Civil #1728
Overpayments

Year	Tax	Interest	Total
1946	$ —0—	$ —0—	$ —0—
1947	—0—	—0—	—0—
1948	986.12		986.12
1949	977.72	.54	978.26
1950	1,401.32	113.48	1,514.80
1951	1,693.56		1,693.56
1952	2,844.56		2,844.56
1953	2,419.42		2,419.42

18. That the plaintiffs are entitled to refunds of the above set forth tax overpayments and the above set forth interest payments, together with interest thereon, and that there is no fatal variance between the refund claims filed for all of these years and the complaints filed herein and that there

is no procedural or substantive rule of law which prohibits the making of these refunds.

Conclusions of Law

1. That the plaintiffs sold the property known as the Buffalo Block to Buttrey Co. pursuant to the agreements referred to above;

2. That the so-called yearly rentals were installment payments on the purchase price, and that they should be treated accordingly for Federal income tax purposes.

3. That such installment payments are subject to long-term capital gain taxation under Section 117 of the 1939 Internal Revenue Code and accordingly the plaintiffs are entitled to receive refunds of tax overpayments, the amounts of which have been stipulated to by the parties and that judgments will be entered for such amounts.

4. That there is no procedural or substantive rule of law which prohibits that judgments be entered for the refunding of the above referred to overpayments.

5. That pursuant to the stipulations of the parties hereto, no refunds shall be made for the 1946 taxable year in case #1727 nor for the 1946 nor 1947 taxable years in case #1728.

/s/ CHARLES N. PRAY,
United States District Judge.

[Endorsed]: Filed October 31, 1957.

In The United States District Court, District of Montana, Billings Division

Civil No. 1727

WILLIAM G. ELLIOT, Plaintiff,

v.

THOMAS M. ROBINSON, Defendant.

JUDGMENT

This cause came on regularly to be heard on the 15th day of June, 1956. The plaintiff appeared by his attorneys, Messrs. James R. Felt and Jack W. Burnett, also Jerome Anderson. The defendant appeared by his attorneys, Dale Galles, Assistant United States Attorney, and John A. Rees, Special Assistant to the Attorney General. Evidence, both oral and written, was submitted. Within the time allowed therefor both parties filed typewritten briefs, requested Findings of Facts, and Conclusions of Law. The Court, being fully advised in the premises, made and filed a typewritten Opinion, Findings of Fact, and Conclusions of Law.

Now, therefore, in accordance with such Findings, Conclusions, and Opinion heretofore entered and filed,

It is Ordered, Adjudged, and Decreed that the plaintiff, William G. Elliot, have and recover judgment against the defendant, Thomas M. Robinson, in the sum of $12,768.84 with interest thereon as provided by law, and his costs allowed by law.

Done this 31st day of October, 1957.

/s/ CHARLES N. PRAY,
United States District Judge.

[Endorsed]: Filed and Entered October 31, 1957.

[Title of District Court and Cause No. 1727.]

CERTIFICATE OF PROBABLE CAUSE

Under authority provided in 28 U.S.C. 2006, pursuant to Rule 69(b) of the Federal Rules of Civil Procedure, the Court finds that the defendant as District Director of Internal Revenue acted under the direction of the Commissioner of Internal Revenue and upon probable cause in the collection of taxes found to be due and owing from him to the plaintiff in the above-entitled action for which a judgment has been entered. A certificate of probable cause should therefore be granted.

Wherefore, it is ordered that a certificate of probable cause be and the same hereby is issued and entered in the above-entitled action and the defendant, Thomas M. Robinson, District Director of Internal Revenue for the Collection District of Montana, is hereby ordered relieved from the payment of said judgment and it is ordered paid out of the proper appropriation from the United States Treasury.

/s/ CHARLES N. PRAY,
United States District Judge.

[Endorsed]: Filed October 31, 1957.

[Title of District Court and Cause Nos. 1727 and 1728.]

STIPULATION RE AMOUNTS OF OVERPAYMENTS

Pursuant to the Order and decision of the court filed June 27, 1957 in the above-entitled actions and also pursuant to Paragraph 23 of the Stipulations of Facts in said actions, the counsel for the respective parties have entered into this agreement involving the amounts of overpayments in the above entitled actions as follows:

1. That, for the purpose of these actions, the parties agree that the correct amounts of overpayments by the plaintiffs herein, are as follows:

Civil #1727
Overpayments

Year	Tax	Interest	Total
1946	$ —0—	$ —0—	$ —0—
1947	3,110.39	52.30	3,162.69
1948	1,431.59	98.03	1,529.62
1949	1,323.43	114.21	1,437.64
1950	1,436.66	12.90	1,449.56
1951	1,628.40		1,628.40
1952	1,790.66	7.96	1,798.62
1953	1,762.31		1,762.31

Civil #1728
Overpayments

Year	Tax	Interest	Total
1946	$ —0—	$ —0—	$ —0—
1947	—0—	—0—	—0—
1948	986.12		986.12
1949	977.72	.54	978.26
1950	1,401.32	113.48	1,514.80
1951	1,693.56		1,693.56
1952	2,844.56		2,844.56
1953	2,419.42		2,419.42

Dated September 30th, 1957.

FELT, FELT, & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiffs.

UNITED STATES ATTORNEY
/s/ By DALE F. GALLES,
Attorney for Defendant.

[Endorsed]: Filed October 31, 1957.

[Title of District Court and Cause No. 1727.]

NOTICE OF APPEAL

Notice is hereby given that Thomas M. Robinson, the defendant named above, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment of the above-entitled Court filed October 31, 1957.

KREST CYR,
United States Attorney,

/s/ DALE F. GALLES,
Assistant U. S. Attorney,

Attorneys for Defendant.

[Endorsed]: Filed December 30, 1957.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Montana—ss.

I, Dean O. Wood, Clerk of the United States District Court for the District of Montana, do hereby certify that the documents accompanying this certificate, to wit:

1. Judgment roll filed October 31, 1957, in Civil 1727,

2. Judgment roll filed October 31, 1957, in Civil 1728,

3. Stipulation filed August 4, 1955, in Civil 1727,

4. Stipulation filed August 4, 1955, in Civil 1728,

5. Order Enlarging Time filed August 6, 1955, in Civil 1727,

6. Order Enlarging Time filed August 6, 1955, in Civil 1728,

7. Motion filed Dec. 13, 1955, in Civil 1727,

8. Motion filed Dec. 13, 1955, in Civil 1728,

9. Consolidation for Trial filed June 15, 1956,

10. Stipulation on Documentary Evidence filed June 15, 1956,

11. Transcript of Evidence filed July 30, 1956,

13. Brief for the Plaintiffs filed December 22, 1956,

14. Correction of Transcript filed February 9, 1957,

15. Affidavit of Service by Mail filed February 19, 1957,

16. Brief for Defendant filed February 19, 1957,

17. Affidavit of Service by Mail filed March 12, 1957,

18. Reply for Plaintiffs filed March 12, 1957,

19. Certificate of Mailing filed April 26, 1957,

20. Brief for Defendant in Rebuttal filed April 26, 1957,

21. Notice of Appeal filed August 26, 1957, in Civil 1727,

22. Notice of Appeal filed August 26, 1957, in Civil 1728,

23. Order filed October 4, 1957, in Civil 1727,

24. Order filed October 4, 1957, in Civil 1728,

25. Application for Extension of Time filed Oct. 4, 1957, in Civil 1727,

26. Application for Extension of Time filed Oct. 4, 1957, in Civil 1728,

27. Certificate of Probable Cause filed Oct. 31, 1957, in Civil 1727,

28. Certificate of Probable Cause filed Oct. 31, 1957, in Civil 1728,

29. Stipulation re Amount of Overpayment filed Oct. 31, 1957,

30. Notice of Appeal filed Dec. 30, 1957, in Civil 1727,

31. Notice of Appeal filed Dec. 30, 1957, in Civil 1728,

Stipulation as to Record on Appeal filed Mar. 25, 1958,

are the original files and records in Civil Actions: No. 1727—William G. Elliot, plaintiff, vs. Thomas M. Robinson, defendant, and No. 1728—Thomas W. Elliot, et al., plaintiffs, vs. Thomas M. Robinson, defendant, and which have been designated by the parties to constitute the record on appeal in said cases, as appears by the stipulation as to record on appeal, which stipulation was filed March 25, 1958.

I Further Certify that plaintiffs' exhibits Nos. 1 and 2 are transmitted with this certificate as part of the record on appeal in said cases, pursuant to the stipulation as to record on appeal.

Witness my hand and the seal of the said Court at Billings, Montana, this 26th day of March, 1958.

[Seal] DEAN O. WOOD,
Clerk,

/s/ By C. G. KEGEL,
Deputy Clerk.

[Title of District Court and Cause No. 1727.]

ORDER

Pursuant to the Application for Extension of Time of defendant, Thomas M. Robinson, ex parte, to file and docket the record on appeal herein, and good cause appearing therefor,—

It Is Now Ordered that the time within which the defendant may file and docket its record on appeal herein be, and hereby is, extended for a period of fifty (50) days, from the date hereof, pursuant to

Rule 73(g) of the Federal Rules of Civil Procedure.

Dated this 7th day of February, 1958.

/s/ W. J. JAMESON,
U. S. District Judge.

[Endorsed]: Filed February 7, 1958 and Entered February 10, 1958.

[Title of District Court and Cause No. 1727.]

DOCKET ENTRIES

1955

May 25—Filed Complaint.

May 27—Issued Summons & 3 copies. Mailed to Marshal at Butte.

Jun. 29—Filed Summons — Served June 20th and June 24th.

Aug. 4—Filed Stipulation granting defendant 60 days additional time to plead.

Aug. 6—Filed and entered Order extending time to plead—60 days.

Oct. 5—Filed Answer of Deft.

Dec. 13—Filed Plaintiff's Motion for a pre-trial conference.

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Jun. 1—Entered Order motion granted.

Jun. 1—Entered Order case noted for trial.

Jun. 6—Entered Order case set for pre-trial conference, and for trial, on June 15, 1956—10 a.m.

Jun. 15—Filed Consolidation for trial, with case #1728.

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Jun. 15—Entered Order consolidating case #1727 with case #1728 for trial.

Jun. 15—Filed Amendment to Complaint.

Jun. 15—Filed Stipulation of Facts.

Jun. 15—Filed Stipulation of documentary evidence.

Jun. 15—Entered record of trial, 60 days to Plaintiff for opening brief—30 days to defendant for answering brief, and 20 days for reply brief.

July 30—Filed Reporter's Notes.

July 30—Filed Reporter's Transcript.

Oct. 23—Filed Receipt for Original Exhibit Plffs. #1, withdrawn, & copy substituted.

Nov. 28—Entered Order extending time for filing of Plffs. Brief to Dec. 31, 1956.

Dec. 22—Filed Plaintiff's Brief.

1957

Feb. 9—Filed Stipulation for correction of Transcript.

Feb. 19—Filed Defendant's Brief.

Feb. 19—Filed Affidavit of service of Brief by mail.

Mar. 12—Filed Reply Brief for Plaintiff.

Mar. 12—Filed Affidavit of Service by Mail.

Apr. 26—Filed Brief for the Defendant in Rebuttal.

Apr. 26—Filed Certificate of mailing.

Jun. 27—Filed Opinion and Order included therein, ruling in favor of Plaintiff.

1957

Jun. 27—Entered Order for Judgment to be rendered in favor of Plaintiff.

Jun. 27—Mailed copy Opinion to counsel for each side; (Felt, Felt & Burnett for Plff. and U. S. Attorney, Billings, for Deft.).

Aug. 26—Filed Notice of Appeal by Defendant.

Aug. 28—Mailed copy Notice of Appeal to counsel for plaintiff.

Oct. 4—Filed Defendant's application for extension of time to docket record on appeal.

Oct. 4—Filed Order extending time to docket record on appeal for 50 days.

Oct. 7—Entered and noted herein, Order extending time to docket record on appeal for 50 days.

Oct. 31—Defendant's proposed Findings of Fact & Conclusions of Law lodged with Clerk.

Oct. 31—Filed Stipulation of amounts of overpayments, applying to this case and to case No. 1728—Thomas W. Elliot et al. vs. Thomas M. Robinson.

Oct. 31—Filed Findings of Fact and Conclusions of Law to apply herein and also to Case No. 1728, Thomas W. Elliot et al. vs. Thomas M. Robinson.

Oct. 31—Filed and entered Judgment for Plaintiff and against defendant for $12,768.84 with interest and costs.

Oct. 31—Mailed Notice of entry of Judgment to all counsel herein.

Oct. 31—Filed Certificate of Probable Cause.

1957

Oct. 31—Filed Judgment Roll.

Dec. 30—Filed Defendant's Notice of Appeal.

1958

Feb. 7—Filed Defendant's Application for Extension of time to docket appeal.

Feb. 7—Filed Order for extension of time to docket appeal.

Feb. 10—Entered Order granting defendant 50 days additional time to docket record on appeal.

Mar. 25—Filed Stipulation as to contents of record on appeal.

Mar. 26—Mailed Record on Appeal to Clerk U. S. Court of Appeals, Box 547, San Francisco, Calif., from Billings Clerk's Office.

Apr. 8—Filed Supplemental Stipulation as to Record on Appeal for this case and Case No. 1728.

[Title of District Court and Causes.]

CERTIFICATE OF CLERK

United States of America,
District of Montana—ss.

I, Dean O. Wood, Clerk of the United States District Court for the District of Montana, do hereby certify that the annexed papers consisting of:

Docket Entries, Civil No. 1727,

Docket Entries, Civil No. 1728,

Order, filed Feb. 7, 1958, Civil No. 1727,

Order, filed Feb. 7, 1958, Civil No. 1728,
Supplemental Stipulation as to Record on Appeal,

are true and correct copies of the docket entries, and the original orders and stipulation which were filed in:

Civil Action No. 1727, William G. Elliot vs. Thomas M. Robinson, and Civil Action No. 1728, Thomas W. Elliot, et al. vs. Thomas M. Robinson, in the above-entitled Court, and which have been designated by the parties as the supplement to the record on appeal in the two above-entitled cases.

I further certify that item 3, Letter from plaintiff's attorneys to Honorable Charles N. Pray, United States District Judge, dated May 6, 1957, in answer to Brief for Defendant in Rebuttal filed April 25, 1957, is not included in the within supplement to the record on appeal, although designated in the Supplemental Stipulation as to Record on Appeal, for the reason that said letter was not filed and is not now among the files and records of said cases in my custody as such Clerk.

Witness my hand and the seal of the United States District Court for the District of Montana, at Great Falls, Montana, this April 9, 1958.

[Seal] DEAN O. WOOD,
Clerk,

/s/ By C. G. KEGEL,
Deputy.

[Endorsed]: No. 15983. United States Court of Appeals for the Ninth Circuit. Thomas M. Robinson, Appellant, vs. William G. Elliot, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Montana.

Filed: March 28, 1958.

Docketed: April 10, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15983

THOMAS M. ROBINSON, Appellant,

vs.

WILLIAM G. ELLIOT, Appellee.

STATEMENT OF POINTS UPON WHICH DEFENDANT-APPELLANT INTENDS TO RELY

The District Court erred in the following respects:

I.

In concluding and holding in the opinion that the plaintiffs made a sale of their property to the Buttrey Company in 1946 or at any time prior to 1955;

that it was so understood by both parties; and that the annual rentals, so called, were installment payments on the purchase price.

II.

In making findings of fact numbered 15, 16, 17 and 18, the last sentence in finding 11, also in not finding as a fact or concluding as a matter of law that:

a. The parties, and certainly the purchaser, did not intend to make an agreement of immediate sale in 1946;

b. No conditional sale was made;

c. The Buttrey Company was not obligated to buy the property, and it acquired no equity in such property until 1955 when the option was exercised;

d. The return as ordinary rental income by the plaintiffs-appellees of the payments which they received from the Buttrey Company bars their claims that such income should be treated as gain from the sale of a capital asset;

e. The complaints did not predicate any recovery upon an alleged sale in 1946 at a profit taxable in that year as capital gain;

f. The plaintiffs-appellees offered no proof, and there is no evidence of record, to show any promise by the Buttrey Company which had a fair market value in 1946; and

g. The absence of any proof of an election by the plaintiffs-appellees to report gain from a sale upon the installment basis precludes any capital gain treatment for years after 1946.

III.

In making conclusions of law numbered 1, 2, 3 and 4, also in not concluding and holding that formal claims for refund, Exhibits H, I and J attached to the complaint in Civil No. 1727, also Exhibits E, F, G and H attached to the complaint in Civil No. 1728, each set forth a ground at variance with and wholly different from the ground of the claim for recovery in such complaints, and that such variance deprived the Court of jurisdiction for the years 1951 to 1953, both inclusive, in Civil No. 1727, also for the years 1950 and 1953, both inclusive, in Civil No. 1728.

IV.

In not entering judgments in defendant-appellant's favor and against the plaintiffs-appellees.

Dated: April 7, 1958.

KREST CYR,
United States Attorney for the District of Montana.

/s/ DALE F. GALLES,
Assistant U. S. Attorney for the District of Montana. Attorneys for Defendant-Appellant.

Acknowledgment of Service Attached.

[Endorsed]: Filed April 10, 1958. Paul P. O'Brien, Clerk.

Nos. 15983-15984

United States
Court of Appeals
for the Ninth Circuit

THOMAS M. ROBINSON, Appellant,

vs.

WILLIAM G. ELLIOT, Appellee.

THOMAS M. ROBINSON, Appellant,

vs.

THOMAS W. ELLIOT, and EVELYN W. ELLIOT, Appellees.

Transcript of Record

(In Two Volumes)

VOLUME II.

(Pages 105 to 152, inclusive)

Appeals from the United States District Court
for the District of Montana

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—6-5-58

Nos. 15983-15984

United States
Court of Appeals
for the Ninth Circuit

THOMAS M. ROBINSON, Appellant,

vs.

WILLIAM G. ELLIOT, Appellee.

THOMAS M. ROBINSON, Appellant,

vs.

THOMAS W. ELLIOT, and EVELYN W. ELLIOT, Appellees.

Transcript of Record

(In Two Volumes)

VOLUME II.

(Pages 105 to 152, inclusive)

Appeal from the United States District Court
for the District of Montana

In the District Court of the United States, District of Montana, Billings Division

No. 1727

WILLIAM G. ELLIOT, Plaintiff,

vs.

THOMAS M. ROBINSON, Director of Internal Revenue, Defendant.

No. 1728

THOMAS W. ELLIOT, Plaintiff,

vs.

THOMAS M. ROBINSON, Director of Internal Revenue, Defendant.

TRANSCRIPT OF PROCEEDINGS

Billings, Montana,
June 15, 1956

Before: Honorable Charles N. Pray.

Appearances: Messrs. Felt and Burnett, Attorneys at Law, Billings, Montana, and Mr. Jerome Anderson, Attorney at Law, Billings, Montana, for Plaintiffs. Mr. Dale Galles, Assistant U. S. Attorney, Billings, Montana, Mr. John A. Rees, Assistant Attorney General, Washington, D. C., for Defendant. [1]*

The above-entitled causes came on regularly for

* Page numbers appearing at bottom of page of Reporter's Transcript of Record.

trial at Billings, Montana, on June 15, 1956, before the Honorable Charles N. Pray, United States District Judge.

Whereupon the following proceedings were had and done, to wit:

The Court: The next case is William G. Elliot vs. Thomas M. Robinson, and Thomas W. Elliot vs. Thomas M. Robinson; the two cases I understand are to be considered together.

Mr. Burnett: Correct.

The Court: And are you ready to proceed? You have some testimony to take?

Mr. Burnett: We are ready to proceed. We would like to make an opening statement.

The Court: Very well, make a short statement on both sides for the record.

Mr. Burnett: These two cases have been consolidated for trial; they involve one basic issue and that is the plaintiffs received certain payments under an agreement which was called a lease agreement and purchase option.

The basic facts, jurisdictional facts have all been stipulated to, and we have stipulated that in the event of a holding for the plaintiffs that the parties will compute any overpayment and submit that to the court. The court won't have to be bothered with computing the tax [3] in other words.

I would like to just briefly describe this agreement and of course we will cover it better in our testimony and in our brief, and we will cover the case law that determines this kind of case.

But we would like to point out the courts are uniformly in agreement that the substance of an agreement will control for federal tax purposes rather than the form that it takes, and in particular the Ninth Circuit in two tax cases has held that agreements entitled leases, somewhat similar to the one in this case, were actually conditional sales agreements and would be treated as such for federal tax purposes rather than as leases.

Now as to some background. The plaintiffs in these cases purchased a business building in Kalispell, Montana, known as the Buffalo Block in 1922.

They were engaged in the retail business. They were operating in this building commercial companies and office space. Now over a period of years their gross rental was approximately $17,000 a year. They paid cash expenses out of that sum in the approximate amount of $9,000 a year, and they incurred depreciation in the approximate rate of $2,000 a year, leaving net income of about $6,000 a year.

The principal tenant in this building [4] for a great number of years was the Flathead Commercial Company, which was engaged in the general selling of dry goods and mercantile business.

Now in 1945 the F. A. Buttrey Company desired to purchase the stock of the Flathead Commercial Company. They didn't want to buy the stock of the corporation; they wanted to buy its assets and after some negotiations a sale was consummated as of January 31, 1946.

Now Mr. Thomas Elliot, one of the plaintiffs in

this case was the principal stockholder of the Flathead Commercial Company, and his reason for selling was generally he wanted to get out of this type business in Kalispell.

As a part of buying this stock the F. A. Buttrey Company wanted the same space they occupied and after some negotiations this agreement, which was dated January 14, 1946, under this agreement Buttreys agreed to pay to the Elliots $19,000 a year for ten years. At the end of the 10 years they had what was called an option to purchase the property for $75,000. This agreement was drawn by the attorneys for Buttreys.

The Buttreys agreed to pay all the taxes, to keep the building insured in at least the amount of $175,000, and to pay all expenses, repairs and wages; the Elliots paid nothing after this agreement was signed. [5]

They in fact took no interest in the building; they didn't take any interest you would expect a landlord to take; they treat it as if the building was sold to Buttreys.

The agreement further provided that the plaintiffs would place a warranty deed in escrow with the Conrad National Bank, and the agreement provided that the bank was to deliver the deed to Buttreys upon the receipt of the $75,000 option if they exercised it, and the agreement provided they contemplated exercising the option.

Now in speaking of reporting net income of $6,000 a year after the agreement was executed, they received $19,000 and that was all net; they

didn't have to pay any expenses, so the context of those figures goes part way at least of showing that these payments called rentals weren't tenant rentals, they were installment payments on the conditional sales contract.

Now in closing I would like to say at a first look or first blush look on this agreement it uses the words lease or rental and perhaps on a careful look that is what it would appear to be, but we feel after complete analysis is made of the agreement, plus the additional facts which surround the case, will conclusively prove or conclusively show that this agreement for federal income tax purposes is to be treated as a conditional sales contract. Thank you.

Mr. Rees: May it please the court. The two suits before the court today involve claims for recovery of money paid as federal income taxes but they are unique in this respect, that at least I do not consider that there is really any tax question involved for the reason in a situation of this kind, as the court will appreciate, the Government is only a stakeholder and I will explain that by suggesting to your Honor, and I am sure Mr. Burnett will agree, that in factual situations of this kind, if we assume that there was a lease entered into between the parties, between the parties, not necessarily the parties in this case, then the lessor in receiving rents represent the money as ordinary income and it is taxed as ordinary income; conversely, the lessee who makes the payments claims deductions on his tax return which normally would be allowed in the regular course of business, and to that extent the

Government collects the taxes justly due as a result of the exchange of money between the parties.

Now on the other hand if we presume that the transaction was a sale, then, of course, the recipient, the vendor and recipient of the payments treats those as payments which may be taxed either as ordinary income or as capital gains.

The parties have stipulated in this case certain facts which so far as these two cases are [7] concerned would occasion capital gain treatment.

Then the purchaser of course would simplify the record payments that he makes on the transaction as expenditures of capital, and the tax problem is one of general application, and the matter of working out the problems of the respective parties is essentially simple. There is no real tax controversy that can arise between the parties.

Now the parties here have been able through their counsel to agree upon a multitude of detail facts which are necessary as a background to a decision by your Honor in the case. I think we have saved substantial time in that regard and we are satisfied among ourselves that the facts, that the statements we make are facts.

We are fortunate in that the Court of Appeals of the Ninth Circuit quite recently, I believe on October 29, 1955, has rendered a decision with which your Honor is familiar in a case involving somewhat similar facts and the same question, so we believe the law is pretty definitely settled now in the Ninth Circuit; but at any rate your Honor has something to guide him in the decision of the

case. I believe that ends any statement that I should make at this time. Thank you.

Mr. Burnett: Your Honor, before we introduce our first witness we have some agreements we have entered [8] into and I thought I would enter those at this time.

The Court: Very well.

Mr. Burnett: Let the record show these cases have been consolidated for trial and the written agreement to that effect has been filed with the Clerk.

Let the record show the attorneys for the parties have stipulated as to certain documentary evidence and they are now filed with the Clerk.

Let the record show in case No. 1727 the plaintiffs have amended their complaint consisting of two paragraphs and the defendant's counsel has agreed that we can amend our complaint; they deny the allegation in paragraph one and admit the allegation in paragraph two.

Mr. Galles: That is correct, your Honor.

Mr. Burnett: And that has been filed.

Let the record show in case No. 1728 the plaintiffs have amended the complaint; it consists of five paragraphs, on which the attorneys for the defendant have no objection to amending the complaint; they deny the allegations in paragraphs one and two and they admit the allegations in paragraphs three, four and five.

Mr. Galles: We acknowledge that to be a correct statement.

Mr. Burnett: Let the record show in case No.

1728 the parties have filed an agreed stipulation of facts and [9] that has been filed with the Clerk.

Mr. Burnett: Let the record show that an exhibit numbered Plaintiff's Exhibit No. 1 for cases 1727 and 1728 has been stipulated as evidence in this case by both parties.

Mr. Galles: We agree to it, however, we would like the opportunity to have this document withdrawn and photostated so the parties may have copies of it.

The Court: Very well, that may be done.

Mr. Burnett: Let the record show Mr. Jerome Anderson is appearing as one of the attorneys for the plaintiffs in both cases.

The Court: Very well.

Mr. Burnett: One further point, your Honor; we are stipulating a similar stipulation of facts in the other case and our secretary is typing that now and she will bring that over sometime during the trial and we will probably enter it.

Mr. Anderson: I would like to say, this, your Honor, at this time the purpose of introducing Plaintiff's Exhibit 1 is so that your Honor understands the use of the exhibit is for the purpose of showing the income received from rentals of the Buffalo Block, which is the property involved in the agreement that is under contest today, during the period 1936 through 1945. I think in [10] other respects the exhibit is self-explanatory; it lists the rents received, total expenses, also depreciation taken and reflects the net income realized by the parties from the use of the building.

Mr. Anderson: Call Mr. Thomas W. Elliott, please.

THOMAS W. ELLIOTT

plaintiff, was called as a witness, and testified as follows:

Direct Examination

Q. (By Mr. Anderson): Tom, can you hear me all right? A. Yes.

Q. Would you state your name, please?

A. Thomas William Elliott.

Q. What is your residence, Mr. Elliott?

A. Kalispell, Montana.

Q. And are you the same Thomas W. Elliott who is one of the plaintiffs in cause 1728 that is being tried here this morning? A. I am.

Q. And who is Evelyn W. Elliott?

A. My wife.

Q. And she also is plaintiff in this action with you, is she, is that correct? A. She is. [11]

Q. How long have you resided in Kalispell, Mr. Elliott? A. Since 1912.

Q. And what is your present age? A. 81.

Q. What is your present occupation?

A. With others operating a furniture store in Billings, Montana named Elliott Brothers, Inc.

Q. And you are an officer of the corporation?

A. I am.

Q. What position do you hold?

A. President and Director.

Q. Did you at any time in the past conduct any business operations in Kalispell, Montana?

A. I did.

(Testimony of Thomas W. Elliott.)

Q. And prior to the year 1946 did you manage and operate a business known as the Flathead Commercial Company? A. I did.

Q. Was that a corporation? A. It was.

Q. And were you an officer of that corporation?

A. Yes, I was.

Q. Actually were you the person that managed and ran the business? A. I was.

Q. How long had that company been in business in Kalispell? [12] A. Many years.

Q. Could you remember when it first went into business, what year? A. It was in the 20s.

Q. About 23 approximately?

A. Something like that.

Q. And in what building in Kalispell was this particular store business located?

A. In the Buffalo Block.

Q. What type business was conducted by the Flathead Commercial Company?

A. Department store.

Q. General merchandise? A. Yes.

Q. And retail sale or is that right?

A. Retail, yes.

Q. Now what portion of the Buffalo Block did the Flathead Commercial Company occupy in the year 1945 and early part of the year 1946?

A. The basement and first floor, that applied to 75 foot frontage.

Q. How many front feet actually?

A. 125.

Q. The Buffalo Block had 125 front footage?

(Testimony of Thomas W. Elliott.)

A. On Main Street, yes, sir. [13]

Q. Would you describe generally for the court the type of building and the type of construction of the building known as the Buffalo Block?

A. Store fronts, brick walls and usual internal divisions supporting the walls.

Q. How many stores did the Buffalo Block have?

A. Two and the basement, first and second floor and basement.

Q. Who actually owned the Buffalo Block, Mr. Elliott? A. My brother and I.

Q. And when did you purchase that building?

A. In 23 I believe.

Q. Was that the same time you commenced the business known as Flathead Commercial Company?

A. The Flathead Commercial Company was in existence before that time.

Q. Now with respect to the space occupied by the Flathead Commercial Company you have testified they occupied 75 front feet on the first floor of the building, what other tenants occupied the other portions of the building? A. Several stores.

Q. In 1945 was that Safeway Stores?

A. Yes.

Q. Were there any other stores on the first floor of that building in 1945? [14] A. No.

Q. And what use did you make of the second floor of the building? A. Offices.

Q. Was the entire second floor rented in the year 1945?

(Testimony of Thomas W. Elliott.)

A. As much as could be, no tenants were refused; there were some vacancies.

Q. How long had Safeway Stores been in the first floor of the building?

A. A number of years. They purchased McMarr.

Q. Did they hold the space in the first floor of the building under lease from you? A. Yes.

Q. When did that lease expire, do you recall?

A. No, I do not.

Q. Would it have been approximately in the year 1947?

A. Well it could have; I just can't answer that positively.

Q. Now in the year 1945 were you approached by any parties who were interested in purchasing the business and the store of the Flathead Commercial Company? A. I was.

Q. And who approached you for that purpose?

A. Representative of Buttrey's, Havre.

Q. Is that the chain store known as Buttreys that [15] operates here in Montana?

A. It was. It is.

Q. And is that the company which eventually executed together with you a certain agreement which is a part of the complaint on file herein and has been entered as evidence by stipulation which is marked K as part of the complaint?

A. Yes, that is the company.

Q. Now when Buttreys first approached you in the latter part of 1945 did you have any intention

(Testimony of Thomas W. Elliott.)

at that time of selling the Flathead Commercial Company? A. I did not.

Mr. Galles: To which we will object, your Honor, as a conclusion of this witness and no proper foundation has been laid.

The Court: Yes, there was subsequently a written agreement entered into between the parties which would ordinarily preclude any verbal discussion beforehand.

Mr. Anderson: Your Honor, initially the purpose of the contract, if I may just make a brief statement here, is to show the circumstances prior to the signing and execution of the agreement which I referred to as Exhibit I. The exhibit I does not refer to the sale of the Flathead Commercial Company itself but I think the information with regard to the sale of that company at a time concurrent [16] to the execution of the agreement marked Exhibit K which is the subject of the proceeding here today for reference for the court's purpose in determining the facts and circumstances surrounding the execution of that agreement.

The Court: Well you may make a brief record of it and the court will consider it, of course, subject to the objection under the general rule applicable in such cases; this might be an exception to the rule because I don't know what you might be able to bring out, what sort of record you might be able to make.

Mr. Anderson: I might just state rather briefly that a Ninth Circuit case in 1955 in Wallburga

(Testimony of Thomas W. Elliott.)

Oesterreich vs. Collector of Internal Revenue, 55-2 United States Tax case book 9733, has declared that in a case of somewhat similar facts to this case involving interpretation of an agreement which initially used the term leasing and so forth on the same question presented here today has stated that in this particular instance the courts commonly consider the conduct of the parties and the legal effect of the instrument, but they stated what the parties believed the legal effect to be on the transaction should be the criterion under which the court should admit evidence and reach its decision. Now in that regard I take it the plaintiffs should be able to show all the facts and circumstances surrounding and so that the court will have [17] the benefit of the information available to it to understand what the parties thought they were doing at the time the transaction was made.

Mr. Galles: Your Honor, in response to that argument in order for counsel to proceed on a theory he must show the contract which finally resulted is ambiguous and need for this explanation in order to interpret the contract. We contend the contract is perfectly clear and speaks for itself, and parol evidence surrounding entering into a contract and its interpretation is not admissible, and I think the same case Mr. Anderson cites says the intention of the parties is not admissible if the contract is clear and unambiguous.

The Court: Well you take the position some ambiguity exists in addition to the necessity of de-

(Testimony of Thomas W. Elliott.)

termining the intent of the parties before they entered into the contract?

Mr. Anderson: Your Honor, I don't quite agree with the theory Mr. Galles has cited here. Generally it is lack of understanding of the law in tax cases before the federal court and before the tax court that this question of, well the admission of parol evidence to show intent of the parties and so forth surrounding the actual execution of the contract and the effect of the instrument itself it is of no importance in this type of tax litigation; that in reality the Government is a third party and was not [18] a party to the written instrument which is submitted here for your consideration here today, and as far as the intention is concerned of the parties, the people who made the instrument have the right to come before the court and show the facts and circumstances surrounding it.

The Court: I will let you make your record and we will determine what to do with it later on.

Mr. Galles: If I may add one thing. I think when counsel says the Government was not a party to the contract I think that is additional support for the position we take in the case.

The Court: Very well, you may make your record as briefly as you can and we will consider it later on and see whether your theory applies.

Mr. Galles: We may have a continuing objection to the circumstances, your Honor.

The Court: Certainly; it is all subject to your objection.

(Testimony of Thomas W. Elliott.)

Mr. Anderson: Read the question and answer.

(Question and answer read.)

Q. (By Mr. Anderson): Actually do you recall when Buttrey's first talked to you about purchasing the Flathead Commercial Company?

A. Well immediately I might say for a few years previous. [19]

Q. But specifically in 1945 when they endeavored to enter into serious negotiations with you do you recall when that was, approximately what part of the year?

A. I would say in vacation time, about July or August.

Q. And then did those negotiations continue with respect to the sale of the Flathead Commercial Company?

A. They later continued, yes.

Q. When, Mr. Elliott, did you first determine that perhaps you desired to sell your store business?

A. Late in 1945 my health wasn't of the best and a long ways from it and I got to thinking that probably the end was near and if it did happen that things would be in bad shape, and my partner had been saying that I should relieve myself of this burden, and one day I came to the conclusion that he was right, I called him up and told him to go ahead, I would make the deal.

Q. Who do you refer to as your partner, is that William G. Elliott? A. Yes.

Q. And he is your brother, is that correct?

(Testimony of Thomas W. Elliott.)

A. Yes, and also Howard Elliott who is my present partner and is the son of W. G. Elliott.

Q. Now when you finally determined that you desired to sell the store business did you then actively continue negotiations with Buttreys at some place other than Kalispell, [20] Montana?

A. I did.

Q. And where was that?

A. Billings, Montana.

Q. And what month of the year 1945 was that?

A. In November.

Q. Did you go to Billings in 1945 in December to discuss this with Buttreys? A. Yes.

Q. And did you continue to negotiate at Billings, Montana, in December, 1945? A. Yes.

Q. And who was present when those negotiations were conducted here in Billings?

A. Here in Billings?

Q. Yes.

A. Well I can't name them correctly. Cliff Banks.

Q. And who was with Mr. Banks?

A. Banks represented the Buttreys.

Q. Was your brother, Mr. William Elliott, present? A. He was.

Q. Was your nephew, Howard Elliott, present?

A. Yes.

Q. Were there other representatives of the Buttreys Stores present? If you don't recall, say so.

[No answer in copy.]

Q. Now at the time you discussed with Buttreys

(Testimony of Thomas W. Elliott.)

the sale of the Flathead Commercial Company did the Buttreys Store corporation make any offer to purchase the Buffalo Block from you and Mr. William G. Elliott?

A. No, not at that time.

Q. Did you assure them however at that time that they would have space available in the block to conduct the business?

A. I did what we did.

Q. What was the arrangement to be as it was specified in 1945 with respect to not remaining in the building? A. Renting it.

Q. And were they to occupy the same space you occupied at the time? A. Yes, they were.

Q. And did they state to your rental price they would be willing to pay you for the floor space occupied by the Flathead Commercial Company?

A. They did.

Q. Do you recall what that price was?

A. I do not.

Mr. Galles: We will object to that as being hearsay.

The Court: He was negotiating so far as the others are concerned; I will let him state under objection, and [22] all of this is subject to objection.

Q. (By Mr. Anderson): Do you recall specifically what that purchase price was—strike that—do you recall specifically what the amount was they would pay you for leasing that space in the first floor of the building?

(Testimony of Thomas W. Elliott.)

A. I don't just remember.

Q. Do you recall how the offer was conveyed to you? A. By letter.

Q. And if I were to show you the letter which you received from Buttreys containing the offer, would that refresh your memory so that you could recall that price?

A. It certainly would.

Q. I hand you a letter dated December 8, 1945, on a letterhead of F. A. Buttreys, signed by Cliff Banks, and ask you if that refreshes your memory of the amount of money Buttreys was to pay you to lease the space occupied by the Flathead Commercial Company? A. It does.

Q. And what amount was that, sir?

A. 15 year lease at $775 per month, for the space now occupied by the Flathead Commercial Company in Kalispell with option to lease the space now occupied by the Safeway Stores at the expiration of their lease in 1947 or sooner should they vacate at $425 a month. [23]

Q. Now finally in December 1945 did you or Buttreys or you and your brother arrive at an agreement and final agreement for the purchase or sale of the goods and business of the Flathead Commercial Company to Buttreys Stores?

A. We did.

Q. And did you assure them at that time that they would be able to lease the space in the building now occupied to conduct the business?

A. We did.

(Testimony of Thomas W. Elliott.)

Q. And did you assure them at that time—And then did you return to Kalispell, Montana?

A. Surely.

Q. Now subsequent to the first day of January, 1946, and in that month were you and your brother again approached with respect to the disposition of the building which was known as the Buffalo Block?

A. It was suggested they might be interested in purchasing it.

Q. And who suggested that, Buttreys?

A. Some representative of Buttreys.

Q. And where was that suggestion made?

A. In Kalispell.

Q. Now at that time did you yourself in the commencement of the negotiations with respect to the sale of the building have any intention of selling your interest in the building? [24]

A. We did not.

Q. Did you then later change your mind with respect to the intention to see the building?

A. Yes, I did.

Q. And when was your attitude changed toward this?

A. During negotiations that month and their making what I thought was a very favorable offer I decided that provided my partner was willing that we would sell it.

Q. During that period of time did they make specific offers of purchase price amounts to you for the building itself? A. They must have.

(Testimony of Thomas W. Elliott.)

Q. Then after you finally decided that you desired to sell the building what occurred? Did you then enter into negotiations in connection with an agreement to be executed relative to the sale?

A. We did.

Q. Did you yourself conduct those negotiations, the major portion of them with respect to that agreement? A. My partner and I did.

Q. Where did you first see this particular agreement, Mr. Elliott, which is marked Exhibit I in the complaint in this action and Exhibit K in the complaint in your brother's action? Where did you first see that agreement? A. In Kalispell.

Q. Where in Kalispell? [25]

A. In the law offices of Walchi and Korn.

Q. Were they lawyers in Kalispell?

A. They are, were, yes, sir.

Q. And who requested you to go to the offices of Walchi and Korn?

A. Well my brother who had been conducting the negotiations came and said and presented them to me and I read it and he asked me to come over and we meet there in the offices of Walchi and Korn.

Q. Were there any representatives of Buttreys in the office of Walchi and Korn at that time?

A. Yes, there was.

Q. And was your brother Mr. William G. Elliott there at that time? A. He was.

Q. Did you read the agreement in the office at that time? A. I did.

(Testimony of Thomas W. Elliott.)

Q. And at that time did you make any suggestions or request any changes in the form of the agreement that merely resulted in changes in the form? A. Not that I recall.

Q. Did you sign the agreement that day in Walchi and Korn's office? A. I did.

Q. Now when you went to that office, Mr. Elliott, what [26] was your intention with respect to the disposition of this property? A. To sell it.

Q. To whom? A. To Buttreys.

Q. Had you employed Kalchi and Korn as attorneys to represent you in connection with this sale?

A. We had not.

Q. Did you at any time pay them any legal fee?

A. We did not.

Q. With respect to representing you in this sale? A. We did not.

Q. After you examined this instrument Exhibit I in your complaint did you consult with any other attorney with respect to the legal effect of that instrument? A. I did not.

Q. Did you consult with any tax consultant or accountant with respect to the tax consequences of that instrument? A. I did not.

Q. Were you at that time trained and have any particular knowledge of taxes?

A. None whatever.

Q. Well now it seems rather strange that you wouldn't have taken this instrument to another attorney for examination; could you explain to the court why you did not? [27]

(Testimony of Thomas W. Elliott.)

A. Well I was probably too simple.

Q. Well was there any other particular reason to trust the attorneys representing Buttreys?

A. I did.

Q. Had you known them before?

A. Yes, they were our attorneys in other matters and had been for years.

Q. So that when they presented the instrument to you you didn't concern yourself with the legal effect of it, is that correct? A. No, I did not.

Q. Now the agreement was executed by you at that time and specifies that an abstract of title brought up to the agreement and warranty deed to the property described in the agreement be placed in escrow in the Conrad National Bank in Conrad, Montana, did you place the agreement in escrow in that bank? A. We did.

Q. And the deed and the abstract were placed in escrow, is that right? A. That is right.

Q. And did that escrow remain in existence until the termination of the agreement which you signed? A. It did.

The Court: Conrad, Montana? [28]

Mr. Anderson: Conrad National Bank in Kalispell.

The Court: You said Conrad, Montana?

Mr. Anderson: I am sorry.

Q. (By Mr. Anderson): Now subsequent to the execution of this agreement, Mr. Elliott, did you following this agreement move out of the Buffalo Block? A. I did.

(Testimony of Thomas W. Elliott.)

Q. And subsequent to the execution of the agreement did you pay any expenses in connection with the operation of that building? A. No.

Q. As a matter of fact have you made any payments for taxes levied against the building or the real property upon which it sets subsequent to the first day of September, 1946? A. No.

Q. Have you made any payments for repairs in connection with the construction of the building?

A. No.

Q. Have you collected any rentals from the tenants of the building? A. No.

Q. In other words, Mr. Elliott, did you completely terminate your relation with the management and control of [29] or control of the building?

A. Not at all except to see the insurance was kept up.

Q. Now I noticed that the contract marked Exhibit I provides that insurance in the amount of at least $175,000 be maintained by Buttreys during the term of the agreement, could you tell us how or why the figure of $175,000 was arrived at?

A. Well I suppose the insurable value.

Q. In other words, in your mind——

A. In other words, there was a difference in the policies at that time where as I remember it that you had to carry a part of the risk yourself. I forget what they call that kind of a policy.

Q. So that in your mind the insurable value of the building was in an amount of at least of $175,000, is that correct?

(Testimony of Thomas W. Elliott.)

A. Yes, at the time; that is the minimum.

Q. Now after the agreement was entered into and for the year 1946 a partnership return was filed on behalf of the partnership which existed between you and your brother with respect to the income received from the Buffalo Block, is that correct?

A. What was that again.

Q. Mr. Elliott, for the year 1946 a partnership return was prepared and filed for you and your brother with respect [30] to the income received by you from rentals during the earlier part of the year and payments on this agreement from the Buffalo Block, is that correct?

A. Previous to 1946.

Q. No, for the year 1946? Well, let me ask you this. Did you have prepared a partnership income tax return? A. Yes, annually.

Q. That was prepared and filed, was it not?

A. Yes.

Q. And who prepared that partnership return for you? A. Gregory B. Duffy.

Q. Now you and Mr. Gregory—did you say?

A. Gregory Duffy was a bookkeeper and valued friend.

Q. Did he live in Kalispell?

A. He did and does.

Q. And what was his occupation at the time he prepared this partnership return for you?

A. Bookkeeping.

Q. Who did he work for?

(Testimony of Thomas W. Elliott.)

A. Kalispell Flour Mills, in existence at that time.

Q. Had he prepared partnership returns for you and your brother in previous years?

A. Yes, every year.

Q. And will you explain to the court the manner in which you gave the information to Mr. Duffy from which he got the [31] figures relative to income and expenses presented to him?

A. I took the rental receipts and records which I kept over to him with the expense cash payment book and all papers in connection with it to his office at the Kalispell Flour Mills and left them with him and he made out the report.

Q. Did he request any particular explanation on any of the entries in the books from you at that time? A. Did he what?

Q. Did he ask you for any particular explanation of any of the entries in the books at that time?

A. Not that I recall.

Q. In other words, you just left the book with him and let him go ahead?

A. Sure, yes, I left them in his hands, at his pleasure.

Q. Now these partnership returns which were signed by you and your brother on income of the Buffalo Block were both state and federal income tax returns, were they not? A. Yes.

Q. Now I have noticed in examining your partnership returns that Mr. Duffy specified therein that the income for the year 1946 received by you

(Testimony of Thomas W. Elliott.)

from the Buffalo Block was referred to therein as rental income, did you instruct him to refer to that as rental income? [32] A. I did not.

Q. When you signed the partnership return did you happen to notice that he had so designated the income? A. I did.

Q. Now after the agreement had been entered into which is referred to here as Exhibit I, Mr. Elliott, and at some later date were you informed that that particular agreement had the effect perhaps of not reflecting a sale of the property?

A. Unofficially, yes.

Q. And where did you first get any information or have anybody give you the idea that perhaps maybe you had signed something you had not intended to sign?

A. At a gathering at a luncheon group in the tea room in the Elks Building in Kalispell, Montana.

Q. And what was the nature of the information that was given to you?

A. Well that it had been slipped over on us and that we were vulnerable.

Q. And how long after the agreement was signed was that?

A. I couldn't say positively; it was a matter of a few weeks, maybe a month or two.

Q. So that later then what was your attitude toward the legal effect of the instrument, did you then realize [33] that perhaps the terminology in

(Testimony of Thomas W. Elliott.)
the instrument referred to something other than a sale?

A. I did and concluded the best thing I could do was keep my mouth shut.

Q. Were you advised thereafter by any person that perhaps your tax returns which had been filed showing income received by virtue of this agreement as rental were incorrectly filed and that you were entitled to a refund? A. Yes.

Q. Who told you that? Did an accountant explain the situation to you? Who told you that the income tax returns possibly had been incorrectly filed? A. I can't answer.

Q. Well to refresh your memory somewhat did your nephew discuss this matter with you some time later, Mr. Howard Elliott? A. Yes, he did.

Q. And how long after this agreement was entered into did Howard Elliott advise and first refer this matter to you? A. Very quickly.

Q. And then I assume you took the necessary steps to file your refund claim is that correct?

A. Yes, to have me file them.

Q. Now, Mr. Elliott, at approximately the same time that the negotiations were completed in the latter part of [34] January and first day of February, 1946, with respect to the sale of the Buffalo Block did you prepare a memorandum for your business files reflecting thereon your understanding as to the business arrangements that had been entered into with Buttreys on this building?

(Testimony of Thomas W. Elliott.)

A. I did for my own on my partnership information.

Q. And did you then place that memorandum in your files? A. I did.

Q. And is that memorandum in existence today?

A. It is.

Mr. Anderson: Mr. Clerk, would you mark this exhibit "Sale of Buffalo Block" as Plaintiff's Exhibit 2?

Q. Now, Mr. Elliott, I hand you a paper entitled at the top "Sale of Buffalo Block, February 1st, 1946" and marked for identification as Plaintiff's Exhibit 2 and ask you if this was the memorandum which you have prepared for your business records?

A. It is.

Q. And is it in the same form today as it was at the time it was prepared? A. Exactly.

Q. Are there any changes on the face of the document other than the mark of the Clerk stating Plaintiff's Exhibit 2? A. Nothing.

Q. And was that prepared for you personally?

A. It was.

Q. And on what date?

A. February 1st, 1946.

Mr. Anderson: At this time, your Honor, I would like to introduce this document in evidence.

Mr. Galles: We will object to the proposed exhibit as being immaterial and irrelevant in this action, your Honor.

The Court: It may go in on the record subject to the objection.

(Testimony of Thomas W. Elliott.)

Q. (By Mr. Anderson): Now referring you, Mr. Elliott, to Plaintiff's Exhibit 2, would you please explain for the record the meaning of the figures reflected thereon so that the court will understand on examining the exhibit what you intended when you wrote the memorandum?

A. Well the object of my making this out was to know what we sold the Buffalo Block for. With that idea in mind I took the matter of the $190,000 that would be paid in ten year period at 3 per cent and figured the interest because we would get that, and that at 3 per cent would be $5,700, but it only would have the total amount one-half of the period, five years, so one-half is—that is wrong—$57,000—one-half is $28,500, and then $75,000 is the final payment, and I figured it at 3 per cent which we would not get until [36] the final payment; that figured up to $22,500. Taking the sum of $28,500 and the sum of $22,500 and adding them together and deducting that amount from the total of the deal, total amount of the deal, $265,000, left me for the building $214,000, figured at 3 per cent.

Q. In other words, would you explain what the figure $265,000 was in your mind?

A. That was the gross amount.

Q. Was that the purchase price?

A. That was the purchase price, yes.

Q. And you were endeavoring to determine by your memorandum in reality what the principal amount was you were receiving from the building

(Testimony of Thomas W. Elliott.)

and figuring interest of 3 per cent at the time of the sale, is that correct?

A. That is right, and I also figured it a couple other rates.

Q. You also figured it at other interest rates, did you? A. Yes.

Q. Now referring again to the agreement which is marked Exhibit K and attached to your complaint and Exhibit K attached to your brother's complaint, did you sign the original agreement of which those exhibits are a copy?

A. What was that question again?

Q. Did you sign the original of the exhibit marked Exhibit I and attached to the complaint of which Exhibit I is [37] a copy? A. Yes.

Q. That agreement provides for payments of $19,000 a year for a period of 10 years with the first payment to be made concurrently with the execution of the contract, did you and your brother receive all of those payments? A. We did.

Q. The agreement further provides for a final payment of $75,000, did you and your brother receive that payment? A. We did.

Q. And when was the final payment received by you and your brother?

A. November 5th, 1955.

Q. And was any notice sent to you by Buttreys Stores that they were going to make this payment prior to your receiving it? A. None.

Q. And was the deed and the abstract and so

(Testimony of Thomas W. Elliott.)

forth given to Buttreys when the final payment was made by the bank?

A. They sent their check to the Conrad National Bank and they handled it for us and credited it to my account the portion of it to come to me.

Q. Now during the period of time that the agreement was in existence to your knowledge was the amount of insurance carried on the building by F. A. Buttrey Company [38] increased in an amount greater than the $175,000 figure called for in the contract? A. Materially, yes.

Q. Do you recall to what amount it was increased? A. $250,000.

Q. Was that at your request? A. No, sir.

Q. How did you receive notice the insurance was increased? A. They sent notice to me.

Q. Now, of course, Mr. Elliott, after filing your refund claims for all of the years specified in the complaint you received notice of the disallowance of those claims or most of them from the United States Government, isn't that correct?

A. That is correct.

Q. With respect to the notice of disallowance for the year 1948 do you recall receiving any such notice from the United States Government?

A. 1948?

Q. Yes. A. I do not recall it, no.

Q. You have no notice in your files at the present time to your knowledge, do you?

A. Not that I am aware of; possibly I am vulnerable on those things. When I received letters

(Testimony of Thomas W. Elliott.)

from the Department [39] of Internal Revenue that this or that matter was disallowed or anything of that kind I took it as being correct and signed it and had my wife sign it and returned it.

Q. Did you consult with any accountant or attorney before you signed those instruments?

A. I did not.

Q. In other words, you just signed them believing in the integrity of the United States Government, is that right?

A. That is correct, the Department of Internal Revenue at Helena.

The Court: We will take a recess. (11:35 A.M.)

Court resumed, pursuant to recess, at 11:45 A.M. at which time all parties and counsel were present.

THOMAS W. ELLIOTT

resumed the stand and testified as follows:

Direct Examination—(Continued)

Q. (By Mr. Anderson): I will just ask you a few more questions, Tom, and you can go back to Kalispell and go fishing. We referred earlier this morning to the increase in the amounts of insurance carried on the building during the term of this transaction by Buttreys, you stating that the insurance was eventually increased to the amount of $250,000. Now do you recall when the first increase was made in the amount of [40] insurance on the building by Buttreys?

A. I couldn't answer as to the definite year but

(Testimony of Thomas W. Elliott.)

it was in the few years after the sale was made, the first increase.

Q. Was that first increase sufficient in amount to bring it to the figure $250,000?

A. No, it was not. I forget the figure but it wasn't that amount.

Q. Then was it again increased later?

A. It was.

Q. And when did the insurance finally reach the amount of $250,000?

A. Well in the last two or three years.

Q. Now at the time this agreement was executed was there any doubt in your mind that Buttreys intended to make all of the payments referred to in the agreement including the final $75,000 payment? A. Never a doubt.

Q. Now of course at the time that you entered into this transaction with Buttreys, Mr. Elliott, you must have had some idea in your mind as to the value, the market value of this property in January of 1946, didn't you?

A. Oh, yes, I thought I did.

Q. You had an opinion then as to the amount that property was worth, is that correct? [41]

A. Yes.

Q. And what in your opinion at that time was the approximate value of that property, the fair reasonable market value of it in January of 1946?

A. In January of 1946?

Q. Yes, sir.

(Testimony of Thomas W. Elliott.)

A. Well, my opinion was around $200,000 more or less.

Q. In any event it was worth to you at that time and you figured it could be sold for more than $75,000, is that correct?

A. It certainly was, yes.

Mr. Anderson: I believe that is all.

Mr. Galles: We have no questions, your Honor.

The Court: Call your next witness.

HOWARD ELLIOTT

was called as a witness and having been first duly sworn testified as follows:

Direct Examination

Q. (By Mr. Anderson): Please state your name, sir? A. Howard William Elliott.

Q. Where do you reside, Mr. Elliott?

A. 1767 Poly Drive, Billings.

Q. What is your age? [42] A. 45.

Q. What is your present occupation?

A. I am manager of Elliot's Furniture.

Q. Is that business located in Billings, Montana? A. It is.

Q. Is that incorporated? A. It is.

Q. And is Mr. Thomas Elliott who previously preceded you on the witness stand an officer of that corporation? A. He is the President.

Q. What capacity do you hold?

A. I am the Vice President and Manager.

Q. Are you related to Mr. Thomas Elliott?

(Testimony of Howard Elliott.)

A. He is my uncle.

Q. And are you related to William G. Elliott?

A. He is my father.

Q. And in years past have you resided in the city of Kalispell?

A. Yes, I was there from the age of 10 through to 28.

Q. And you left there and subsequently wound up living in Billings, is that correct?

A. That is correct.

Q. Now you have heard the testimony of Thomas Elliott this morning, your uncle, and he referred to certain negotiations with the sale of the Flathead Commercial [43] company that were conducted in the latter part of the year 1945, were you acquainted with the negotiations?

A. Yes, sir.

Q. Did you participate in those negotiations?

A. I did.

Q. When did you first become involved in negotiations for the sale of that store and business?

A. Possibly in 43 or 44 when I was trying to urge my uncle to sell.

Q. Why were you endeavoring to urge him to sell?

A. In my opinion his health was such he would be better off out of business then.

Q. And what was the condition of your father's health at that time? A. Not good.

Q. Was he actively engaging in the business of

(Testimony of Howard Elliott.)

the Flathead Commercial Company or the management of the Buffalo Block at that time?

A. No.

Q. Now were you personally approached by Buttreys with respect to the sale of this business?

A. Only in so far as to obtain my influence to get my uncle to agree to sell.

Q. And when they approached you with respect to the sale of the business did they mention anything in connection [44] with the building known as the Buffalo Block? A. They did not.

Q. Now in connection with the negotiations that were conducted in December, 1945, were you present during those negotiations? A. I did not.

Q. And did you advise your uncle to sell that particular part of the business? A. I did.

Q. At that time was any reference made by Buttreys to the continuance of the use of the space occupied by the Flathead Commercial Company on the first floor of the Buffalo Block?

A. Not specifically.

Q. Was any reference made then possibly leasing that particular property or that particular space in that building?

A. At that meeting that was fairly well understood due to our previous offer they did ask my uncle if he had changed his mind about selling and he said no.

Q. Now what was your advice at that time to your uncle and your father with respect to the disposition of the Buffalo Block?

(Testimony of Howard Elliott.)

Mr. Galles: We object to this, your Honor, on the same grounds as previously stated.

The Court: It may be received subject to the objection. [45]

A. My advice was to sell.

Q. And were you present in Kalispell, Montana thereafter at the time that the negotiations were conducted with reference to the sale of this building? A. I was not.

Q. Did you know anything about the fact that they had been contacted by Buttreys on that agreement such as Exhibit K was about to be entered into between them? A. I did not.

Q. When was the first time that you received knowledge of the fact your uncle and his brother had entered into the agreement marked Exhibit K in the complaint of your uncle's in this action?

A. I can't recall exactly but I would say within a few weeks subsequent to the filing, signing of the agreement.

Q. And did either your uncle or your father indicate to you after the execution of that agreement their opinion as to the legal effect of that agreement? A. They did not.

Q. Did they ever indicate to you later whether they at that time had intended the agreement to effect a sale or rental of the property?

A. Will you repeat that? They both know they had sold the property.

Q. Did they so inform you? [46]

(Testimony of Howard Elliott.)

A. Yes.

Q. Now Thomas Elliott has testified previous to you in this action that he received certain advice from you relative to the possibility of his obtaining refunds from the United States Government on tax returns filed by him for the years commencing 1946 and on through the year 1953, did you so advise him? A. I did.

Q. Would you tell us briefly how this situation arose?

A. In earlier years my father resided in Missoula and Gregory Duffy had been handling all his income tax returns. He moved from Missoula to Billings I believe in 1946 or early 47 or late 46, and for one or two years Mr. Duffy continued as an accountant. On my advice, I suggested that he transfer that job from Kalispell to Billings for a matter of convenience and Mr. Frank Hoile was employed to file those returns. Mr. Hoile advised me that in his opinion my father was entitled to a refund on income tax for the years 46, 7 and 8 and 9 up until the time he filed the return for the current year which I believe was 50.

Q. So on that basis you advised your father and subsequently your uncle to take some action in this matter, is that correct? A. That is correct.

Q. Did either of them realize at the time that you advised, so advised them that any advantage had been taken over them by Buttreys Stores with respect to the tax consequences of this agreement?

Mr. Galles: To which we object as being a con-

(Testimony of Howard Elliott.)

clusion of this witness and without proper foundation.

Mr. Anderson: We will rephrase the question.

Q. Did either your uncle or your brother at the time that you first informed them that they might have some refunds coming from the Government on their tax return, did either of them indicate to you or inform you that they had any knowledge that Buttreys Stores had taken advantage of them tax-wise in connection with the agreement which had been executed?

A. Yes, I had previously advised them to that effect.

Q. But prior to your giving them any advice or at the time you first gave it to them did they indicate to you they knew they had been taken advantage of? A. No, they did not.

Q. Now at the time the negotiations were conducted at Billings did Buttreys indicate then specifically whether or not they desired to purchase the property or were interested in purchasing the Buffalo Block?

A. Only insofar as they asked them if they had changed their mind about not deciding to sell. [48]

Mr. Anderson: That is all.

Mr. Galles: No questions.

S. GEDDES

was called as a witness by plaintiffs and having been first duly sworn testified as follows:

Direct Examination

Q. (By Mr. Anderson): Would you state your name, please? A. S. Geddes.

Q. Where do you reside?

A. Kalispell, Montana.

Q. How long have you lived in Kalispell?

A. Since 35.

Q. What is your present age? A. 59.

Q. What is your occupation?

A. Insurance agent.

Q. And what type insurance do you sell, Mr. Geddes.

A. Fire and casualty and allied lines.

Q. Does this include insurance policies by companies who represent, who insure buildings, commercial properties, etc.? A. That is right.

Q. How long have you been in the general insurance [49] business?

A. Since 41, I believe, 40, somewheres along there.

Q. And during that period of time and prior thereto were you engaged in any other form of business? A. Real estate business.

Q. And would you state how long you have been engaged in the real estate business?

A. Approximately ten years.

Q. And are you still actively engaged in that business? A. No.

(Testimony of S. Geddes.)

Q. How long ago did you terminate the business? A. Two years.

Q. Was all of your experience in the real estate business gained in the city of Kalispell, Montana? A. That is correct.

Q. And would you just state briefly the nature of the real estate business referred to in which you engaged?

A. Well we sold buildings, took listings to sell dwellings, properties of various nature, appraisals on real estate or courtesy appraisals, and where we suggest a selling price.

Q. In other words, during the course of your business of being a real estate agent you also engaged then I take it from time to time in appraisals of properties for the purposes mentioned by you, is that correct? [50] A. That is correct.

Q. During that same period of time then were you also engaged in the sale of risk insurance on properties? A. Yes, sir.

Q. Now during your experience as a real estate man in Kalispell, Montana, have you appraised or valued commercial real estate properties in the business district of Kalispell, Montana?

A. I have.

Q. And was that for the same purpose you previously mentioned in your testimony?

A. Yes, sir.

Q. Have your appraisals been accepted?

A. They have.

Q. Have they even been questioned?

(Testimony of S. Geddes.)

A. Not to my knowledge.

Q. Were you in the year 53 requested to appraise the real property only upon which a business known as the Buffalo Block was located?

A. Yes, sir.

Q. And who requested you to make this appraisal?

A. Howard Elliott, Billings, Montana.

Q. Were you acquainted with Mr. Howard Elliott previous to the time he came in and asked you to make this appraisal? A. I was not.

Q. Did he inform you at the time he requested the appraisal the purpose for which the appraisal was being made?

Mr. Galles: We will object to this line of questioning, your Honor, because it is immaterial and irrelevant and on the same grounds stated it has nothing to do with the issue in the case as we see it.

The Court: Well, it would seem so but we will let him make his record; your objection will be considered later.

(Question read.)

A. He did not.

Q. Did he ask you to make the appraisal as of 53 or as of some previous year?

A. As of the previous year.

Q. What year was that? A. 46.

Q. Did you so make that appraisal?

A. I did.

Q. Do you have an opinion as to the value of

(Testimony of S. Geddes.)
the real estate upon which is situated a building known as the Buffalo Block, Kalispell, Montana, as of the year 56—or 46—I am sorry?

A. I am.

Q. And in your opinion, Mr. Geddes, what was the fair reasonable market value of this real property in the year 46? [52]

A. 935 a running front foot.

Q. And how many running front feet are contained in the lots upon which the Buffalo Block is situated? A. 125.

Q. So therefore, Mr. Geddes, what would be the total valuation of that real property as of the year 46? A. $116,875, I believe.

Q. Is that a specific figure now you are certain of or would you care to compute it?

A. Well it could be computed. Well I could compute it.

Q. Would you please do so?

A. It seems to multiple out.

Q. Then what is the figure you arrived at as a result of your computation? A. 116,875.

Q. Dollars? A. Dollars.

Q. Now does that figure include the building situated upon the real property?

A. No, it does not.

Q. Now this agreement which has been referred to previously this morning, Mr. Geddes, in the testimony of Mr. Elliott, provided that the building located upon this property should be insured in an amount at least as great as the sum of

(Testimony of S. Geddes.)

$175,000, in your opinion was that amount [53] excessive, approximately correct; would that amount reflect in other words the value of the commercial building located upon that property at that time? A. It would not.

Q. And what do you mean when you say it would not?

A. I was requested to appraise the real property without building or improvements.

Q. Perhaps you misunderstood my question. I am asking you whether you made appraisal in 46. I am asking you whether the amount of insurance required to be carried on the building by the contract, that amount being $175,000, was greater than the value of the building in your opinion in the year 46?

A. It was not.

Q. Now subsequent to the execution of this agreement, Mr. Geddes, have you carried or has your company retained some of the insurance that has been carried on the building known as the Buffalo Block?

A. We were contributing agents.

Q. And were those policies at least in the amount from the time after the year 46 through the year 55 increased?

A. They were increased twice but I would not, I do not recall the dates.

Q. Well now when you say increased in price?

A. Increased twice. [54]

(Testimony of S. Geddes.)

Q. I am sorry. I misunderstood you. Who requested the increases be made in the insurance?

A. F. A. Buttrey Company, Havre.

Q. Was any request made of you by either of the two Elliotts involved in these two cases?

A. No.

Mr. Anderson: That is all.

Mr. Galles: No cross examination.

The Court: Do you have some further testimony?

Mr. Anderson: Your Honor, the other plaintiff, Mr. William G. Elliott, in the companion case is present in the courtroom; he however fell in April of this year and was injured and I really do not feel is in physical condition to testify here today. We will not call him particularly because of his physical condition and the fact he suffered a blow on the head as a result of a fall and has certain lapses of memory; he is 78 years old and has not fully recovered from the injury he has received and he is here today and I would like the record to show that.

The Court: Very well.

The Court: Have you some testimony?

Mr. Galles: No, your Honor.

Mr. Burnett: I would just like to emphasize issue, that we have agreed between the parties that we will then compute what any overpayments would be and submit that to the court at that time.
again, your Honor, we have stipulated that if the court [55] finds for the plaintiffs on this basic

Mr. Anderson: The plaintiff rests, your Honor, in both causes.

Mr. Galles: We have no evidence to offer, your Honor. We rely on the statement and our theory of the case as stated and we feel the only question is the construction of the instrument itself, which is clear and unambiguous.

Mr. Burnett: Your Honor, we would like to request two months for our first brief and one month for any reply.

The Court: Well I suppose you need the record, do you?

Mr. Burnett: Yes, we need the two months from the time we get the transcript; we need the transcript.

The Court: Is that agreeable on the other side?

Mr. Galles: We don't need that much, your Honor, but we have no objection.

Mr. Anderson: Your Honor, I might say at this time there might be some question in the record as to our position with respect to the instrument itself; I don't want the court to have the idea that we don't have the feeling that the instrument is ambiguous; in other words, we feel that the [56] instrument is susceptible to interpretation that the fact the instrument does not reflect the true intent of the instrument and that the language does not reflect the true intent and legal effect of the instrument in that really it is ambiguous and I want to make that clear for the record.

Mr. Burnett: Your Honor, we now have the stipulation in the William Elliott case which was

being typed this morning and we will go over that with counsel for the time and enter it with the Clerk after we agree.

The Court: Well under all the circumstances after receipt of the transcript you may take 60 days for your briefs and you may have 30 days or as much less time as you need; if you want to take 60 days, I will treat you the same as the other side.

Mr. Galles: 30 days is satisfactory, your Honor.

The Court: And then you may have 20 days to reply. That seems to conclude our business then in this case. (12:15 P.M. June 15, 1956.) [57]

[Endorsed]: Filed July 30, 1956.

[Endorsed]: Nos. 15983 and 15984. United States Court of Appeals for the Ninth Circuit. Thomas M. Robinson, Appellant, vs. William G. Elliott, Appellee. Thomas M. Robinson, Appellant, vs. Thomas W. Elliot and Evelyn W. Elliot, Appellees. Transcript of Record. Appeals from the United States District Court for the District of Montana.

Filed: March 28, 1958.

Docketed: April 10, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

No. 15984

United States
Court of Appeals
for the Ninth Circuit

THOMAS M. ROBINSON, Appellant,

vs.

THOMAS W. ELLIOT and EVELYN W. ELLIOT, Appellees.

Transcript of Record

(In Two Volumes)
VOLUME I.
(Pages 1 to 64, inclusive)

Appeal from the United States District Court
for the District of Montana

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—6-9-58

No. 15984

United States
Court of Appeals
for the Ninth Circuit

THOMAS M. ROBINSON, Appellant,

vs.

THOMAS W. ELLIOT and EVELYN W. ELLIOT, Appellees.

Transcript of Record

(In Two Volumes)
VOLUME I.
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Appeal from the United States District Court
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Billings, Montana,

Attorneys for Appellees.

In The United States District Court, District of Montana, Billings Division

No. 1728

THOMAS W. ELLIOT and EVELYN W. ELLIOT, Plaintiffs,

vs.

THOMAS M. ROBINSON, Defendant.

COMPLAINT

Plaintiffs, by their attorneys, for their complaint herein allege:

(1) This complaint is filed, and this action is instituted, pursuant to the provisions of Section 322 of the Internal Revenue Code of 1939 (U.S.C. Title 26, Sec. 322) and Section 6402 of the Internal Revenue Code of 1954 for the recovery of Federal income taxes and interest thereon, paid for the calendar years 1946, 1947, 1948, 1949, 1950, 1951, 1952 and 1953.

(2) The plaintiffs are husband and wife, residing at 502 Third Avenue East, Kalispell, Montana, and they are residents of the District of Montana.

(3) This action again Thomas M. Robinson, U. S. District Director of Internal Revenue for the District of Montana, arises under the Act of June 25, 1948, 62 Stat. 932, United States Code, Title 28, Sec. 1340.

(4) This action arises under the laws of the United States, to-wit: Section 117 of the Internal Revenue Code of 1939.

(5) The plaintiffs duly filed their Federal income tax return for the calendar year 1946 with the above-named defendant. The plaintiffs paid, on or before March 15, 1947, the amount of $7,-350.69, the Federal income tax for 1946 shown to be due by said return.

(6) The plaintiffs duly filed with the defendant, a timely claim for refund of $2,472.01 income tax paid for the year 1946. A true copy of said claim for refund is attached hereto and marked Exhibit "A".

(7) The plaintiffs duly filed their Federal income tax return for the calendar year 1947 with the above-named defendant. The plaintiffs paid, on or before March 15, 1948, the amount of $8,-368.55, the Federal income tax for 1947 shown to be due by said return. On or about September 15, 1950, pursuant to a notice and demand received from the above-named defendant, the plaintiffs paid a deficiency in income tax for the calendar year 1947 in the amount of $384.69, together with interest thereon of $57.70, said payments being made to the above-named defendant.

(8) On or before March 15, 1951, the plaintiff duly filed with the defendant a timely claim for refund of $2,155.70, income tax paid for the year 1947. A true copy of said claim for refund is attached hereto and marked Exhibit "B".

(9) The plaintiffs duly filed their Federal income tax return for the calendar year 1948 with the above-named defendant. The plaintiff paid, on or before March 15, 1949, the amount of $3,791.06, the Federal income tax for 1948 shown to be due by said return.

(10) On or before March 15, 1952, the plaintiffs duly filed with the defendant a timely claim for refund of $1,088.12, income tax paid for the year 1948. A true copy of said claim for refund is attached hereto and marked Exhibit "C".

(11) The plaintiffs duly filed their Federal income tax return for the calendar year 1949 with the above-named defendant. The plaintiffs paid, on or before March 15, 1950, the amount of $3,-167.10, the Federal income tax for 1949 shown to be due by said return.

(12) On or before April 5, 1951, the plaintiffs duly filed with the defendant a timely claim for refund of $1,050.50, income tax paid for the year 1949. A true copy of said claim for refund is attached hereto and marked Exhibit "C". On or about March 16, 1954, the plaintiffs duly filed with the defendant an amended claim for refund of $3,-167.10, income tax paid for the year 1949. A true copy of said amended claim for refund is attached hereto and marked Exhibit "D".

(13) The plaintiffs duly filed their Federal income tax return for the calendar year 1950 with the above-named defendant. The plaintiffs paid,

on or before March 15, 1951, the amount of $5,-412.02, the Federal income tax for 1950 shown to be due by said return. On or about October 4, 1951, pursuant to a notice and demand received from the above-named defendant, the plaintiffs paid a deficiency in income tax for the calendar year 1950 in the amount of $1,508.90, together with interest thereon of $134.12, said payments being made to the above-named defendant.

(14) On or before March 15, 1954, the plaintiffs duly filed with the defendant a timely claim for refund of $6,920.92, income tax paid for the year 1950. A true copy of said claim for refund is attached hereto and marked Exhibit "E".

(15) The plaintiffs duly filed their Federal income tax return for the calendar year 1951 with the above-named defendant. The plaintiffs paid, on or before March 15, 1952, the amount of $2,-850.84, the Federal income tax for 1951 shown to be due by said return.

(16) On or about July 9, 1954, the plaintiffs duly filed with the defendant a timely claim for refund of $2,850.84, income tax paid for the year 1951. A true copy of said claim for refund is attached hereto and marked Exhibit "F".

(17) The plaintiffs duly filed their Federal income tax return for the calendar year 1952 with the above-named defendant. The plaintiffs paid on or before March 15, 1953, the amount of $2,-

814.04, the Federal income tax for 1952 shown to be due by said return.

(18) On or about July 8, 1954, the plaintiffs duly filed with the defendant a timely claim for refund of $2,814.04, income tax paid for the year 1952. A true copy of said claim for refund is attached hereto and marked Exhibit "G".

(19) The plaintiffs duly filed their Federal income tax return for the calendar year 1953 with the above-named defendant. The plaintiffs paid, on or before March 15, 1954, the amount of $3,004.94, the Federal income tax for 1953 shown to be due by said return.

(20) On or about July 8, 1954, the plaintiffs duly filed with the defendant a timely claim for refund of $3,004.94, income tax paid for the year 1953. A true copy of said claim for refund is attached hereto and marked Exhibit "H".

(21) The Commissioner of Internal Revenue disallowed the claim for refund for 1946. This complaint is filed within two years of the time of the receipt of the statutory disallowance of the claim for refund for 1946.

(22) On January 14, 1946, the plaintiffs, together with William G. Elliot, transferred to the F. A. Buttrey Company, a Montana corporation, certain real estate and a business building located thereon in Kalispell, Montana. The total consideration was payable commencing on February 1, 1946,

at the rate of $19,000.00 a year for ten years, at which time a final payment of $75,000.00 would be payable unless the buyer elected not to make the final payment, in which event the deed to the said property would be returned to the sellers by the escrow holder thereof. The above-described transfer was carried out pursuant to an agreement between the above-named parties. Said agreement was entitled "Lease Agreement and Purchase Option", and it was executed on January 14, 1946. Said agreement is expressly incorporated herein by reference and a true copy of said agreement is attached hereto and marked Exhibit "I". A subsequent amendment to the above agreement between the above-named parties entitled "Memorandum Agreement" was executed on February 1, 1946, and said agreement is expressly incorporated herein by reference and a true copy of said agreement is attached hereto and marked Exhibit "J".

(23) The plaintiffs were and are entitled to $9,000.00 a year out of the $19,000.00 yearly payments and to $35,526.32 of the final payment of $75,000.00. The amount received by the plaintiffs in 1946 was $9,000.00.

(24) Prior to entering into the agreements with the F. A. Buttrey Company, referred to in paragraph (22) above, the plaintiffs owned an undivided one-half interest in the above-described property. Said property had been held for more than six months. The plaintiffs' adjusted basis for determining gain under the Internal Revenue Code

of 1939 with respect to said property was $19,321.63 on January 14, 1946.

(25) On January 31, 1946, Thomas W. Elliot, one of the plaintiffs herein, as President of the Flathead Commercial Company, a Montana corporation, executed an "Affidavit and Statement By Seller to Purchase Under Bulk Sales Law." Said affidavit is expressly incorporated herein by reference and a true copy of said affidavit is attached hereto and marked Exhibit "K". The Flathead Commercial Company, which had for many years engaged in the dry goods and clothing business in Kalispell, Montana, sold all of its stock of merchandise and furnishings to the aforesaid F. A. Buttrey Company on or about January 31, 1946. Prior to such sale, the Flathead Commercial Company leased the property involved in the transfer set forth in paragraph (22) above. The majority of the stock of the Flathead Commercial Company was owned by the above-named plaintiffs. Said company was liquidated on or about January 31, 1946, at which time the plaintiffs retired from the business of operating and conducting a dry goods and clothing business.

(26) The Commissioner of Internal Revenue, in disallowing the 1946 claim for refund, erroneously treated the $9,000.00 received by the plaintiffs in 1946 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(27) The Commissioner of Internal Revenue disallowed the claim for refund for 1947.

(28) The plaintiffs in 1947 received $9,000.00 pursuant to the agreement set forth in paragraph (22) above.

(29) The Commissioner of Internal Revenue, in disallowing the 1947 claim for refund, erroneously treated the $9,000.00 received by the plaintiffs in 1947 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(30) The Commissioner of Internal Revenue disallowed the claim for refund for 1948. This complaint is filed within two years of the time of the receipt of the statutory disallowance of the claim for refund for 1948.

(31) The plaintiffs in 1948 received $9,000.00 pursuant to the agreements set forth in paragraph (22) above.

(32) The Commissioner of Internal Revenue, in disallowing the 1948 claim for refund, erroneously treated the $9,000.00 received by the plaintiffs in 1948 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long-term capital gain under Section 117 of the Internal Revenue Code of 1939.

(33) The Commissioner of Internal Revenue disallowed the claim for refund for 1949. This complaint is filed within two years of the time of

the receipt of the statutory disallowance of the claim for refund for 1949.

(34) The plaintiffs in 1949 received $9,000.00 pursuant to the agreements set forth in paragraph (22) above.

(35) The Commissioner of Internal Revenue, in disallowing the 1949 claim for refund, erroneously treated the $9,000.00 received by the plaintiffs in 1949 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(36) The Commissioner of Internal Revenue has taken no action to date regarding the claims for refund for the years 1950, 1951, 1952 and 1953. This complaint is filed after a period of six months has elapsed since the filing of each of the refund claims for the aforesaid years.

(37) The plaintiffs, in each of the years 1950, 1951, 1952 and 1953, received $9,000.00 pursuant to the agreements set forth in paragraph (22) above. Said amounts were erroneously reported and taxed in the plaintiffs' Federal income tax returns for 1950, 1951, 1952 and 1953 as ordinary rental income. The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939.

(38) By virtue of the aforesaid, the defendant becomes and is indebted to the plaintiffs for $2,472.01, income tax paid for the calendar year 1946;

and for $2,213.40, for income tax paid together with interest paid thereon, for the calendar year 1947; and for $1,088.12, income tax paid for the calendar year 1948; and for $2,635.16, income tax paid for the calendar year 1949; and for $2,844.86, income tax paid together with interest paid thereon, for the calendar year 1950; and for $1,982.20, income tax paid for the calendar year 1951; and for $2,084.27, income tax paid for the calendar year 1952; and for $2,337.84, income tax paid for the calendar year 1953; which amounts have not heretofore been refunded or credited, together with interest on such amounts as provided by law.

Wherefore, the plaintiffs demand judgment against the defendant in the amount of $17,657.86 with interest thereon as provided by law, together with the costs of this action.

Dated: May 24, 1955.

FELT, FELT & BURNETT,
/s/ By JAMES R. FELT,
Attorneys for Plaintiff.

EXHIBIT "A"

CLAIM

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

(X) Refund of Taxes Illegally, Erroneously, or Excessively Collected.

* * * * *

Exhibit "A"—(Continued)

State of Montana,
County of Flathead—ss.

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Business address: 502—3rd Avenue East.

Residence: Kalispell, Montana.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Helena.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from 1/1, 1946, to 12/31, 1946.

3. Character of assessment or tax: Individual Income Tax.

4. Amount of assessment: $6,886.10; dates of payment: .....

5. Date stamps were purchase from the Government: .....

6. Amount to be refunded: $2,472.01.

7. Amount to be abated (not applicable to income, gift, or estate taxes): .....

8. The time within which this claim may be legally filed expires, under section 322 (b) of Internal Revenue Code on (Unknown), 19...

The deponent verily believes that this claim should be allowed for the following reasons, as stated in Schedules and Exhibits attached hereto made a part of this claim as follows:

Exhibit "A"—(Continued)

Schedule 1 .....Page 1
Schedule 1-A .....Page 2
Schedule 2 .....Page 3
Exhibit A .....Page 4
Exhibit A-1 .....1950 Claim Page 5

* * * * *

Pa

Thomas W. and Evelyn W. Elliot
502 — 3rd Avenue East
Kalispell, Montana

Adjustments—1946
Schedule 1

Items	Returns	Additions	Deductions	Corr
1. Wages and Salaries	$ 8,623.00			$ 8,62
2. Dividends	185.16			18
3. Net Gain—Capital Assets	2,781.97	3,843.80		6,62
4. Net Cain Short Term Capital Assets	5,029.68			5,02
5. Buffalo Block	9,385.41		9,000.00	38
6. Total Income	$26,005.22	$3,843.80	$9,000.00	$20,84
7. Deductions:				
8. Contributions	3,665.75			3,66
9. Interest	725.00			72
10. Taxes	636.11			63
11. Total Deductions	5,026.86			5,02
12. Net Income				15,82

Page 2

Adjustments Explained—1946
Schedule 1-A

Item 3. Net Gain—Capital Assets	6,625.77
Previously Determined	2,781.97
Adjustment	3,843.80

Exhibit "A"—(Continued)

Gain on sale of property on installment basis as determined in Exhibit-A attached hereto, is based upon facts and interpretation of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiation, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of the ten-year period for $75,000.00, or a total of $265,000.00. Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Item 5. Buffalo Block, reported	9,385.41
Corrected	385.41
Adjustment	9,000.00

See explanation for Item 3.

Note: Records could not be found as to date of filing of original return. Claim is therefore filed since the time within which this claim may be legally filed, is uncertain. Relief is also sought under provisions of Section 275 (c) Internal Revenue Code upon the same grounds, although not now so provided.

Page 3

Tax Computation—1946
Schedule 2

Net Income from Schedule No. 1	15,822.16	
Less: Exemptions (2)	1,000.00	
	14,822.16	
Combined Tentative Normal Tax and Surtax		4,646.41
Less 5%		232.32
Total Tax—Corrected		4,414.09
Tax Previously Paid		6,886.10
Over Assessment Claimed		2,472.01

Exhibit "A"—(Continued)

EXHIBIT A

Pa

WM. G. ELLIOT
Billings, Montana

T. W. ELLIOT
Kalispell, Montana

Net Gain—Sale of Capital Assets

Sale Price			$265,0
Cost			
Land		$15,000.00	
Buildings	$68,000.00		
Improvements—1924			
1925			
1929	5,873.79		
	$73,873.79		
Less: Depreciation Reserve			
12/31/45 per R.A.R.	$50,054.17		
1/1 to 1/31/46	176.35		
	50,230.52		
		23,643.27	
			38,6
Net Profit on Sale			$226,3

		Installments	Reportable Profit	Taxable Profit
Payments	2/1/46	$ 19,000.00	$ 16,229.35	$ 8,114.68
	2/1/47	19,000.00	16,229.35	8,114.68
	2/1/48	19,000.00	16,229.35	8,114.68
	2/1/49	19,000.00	16,229.35	8,114.68
	2/1/50	19,000.00	16,229.35	8,114.68
	2/1/51	19,000.00	16,229.35	8,114.68
	2/1/52	19,000.00	16,229.35	8,114.68
	2/1/53	19,000.00	16,229.35	8,114.68
	2/1/54	19,000.00	16,229.35	8,114.68
	2/1/55	19,000.00	16,229.35	8,114.68
	2/1/56	75,000.00	64,063.23	32,061.62
		$265,000.00	$226,356.73	$113,208.42

Exhibit "A"—(Continued)

Summary			
Wm. G. Elliot—1946-55	$10,000.00	$ 4,270.88	$42,708.80
Wm. G. Elliot—1956	39,473.68	16,874.54	16,874.54
Tom Elliot—1946-55	9,000.00	3,843.80	38,438.00
Tom Elliot—1956	35,526.32	15,187.08	15,187.08
			$113,208.42

EXHIBIT "B"

CLAIM

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

(X) Refund of Taxes Illegally, Erroneously, or Excessively Collected.

* * * * *

State of Montana,
County of Flathead—ss.

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Business address: Kalispell, Montana.
Residence: 502 — 3rd Avenue East.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Helena, Montana.

2. Period (if for tax reported on annual basis,

Exhibit "B"—(Continued)

prepare separate form for each taxable year) from 1/1, 1947 to 12/31, 1947.

3. Character of assessment or tax: Individual Income.

4. Amount of assessment: $9,062.05; dates of payment: Unknown.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $2,155.70.

7. Amount to be abated (not applicable to income, gift, or estate taxes): .....

8. The time within which this claim may be legally filed expires, under section 322 (b) of Internal Rev. Code., on March 15, 1951.

The deponent verily believes that this claim should be allowed for the following reasons, as stated in Schedules and exhibits attached hereto made a part of this claim as follows:

Schedule 1 .....Page 1
Schedule 1-A .....Page 2
Schedule 2 .....Page 3
Exhibit A .....Page 4
Exhibit A-1 .....1950 Claim Page 5

* * * * *

Exhibit "B"—(Continued)

Thomas W. and Evelyn W. Elliot
502 — 3rd Avenue East
Kalispell, Montana

Page 1

Adjustments—1947
Schedule 1

Items—Income:	Returns	Additions	Deductions	Corrected
Wages and Salaries	2,702.00			2,702.00
Dividends	15,828.16			15,828.16
Interest	375.00			375.00
Long Term Gains Exchange Cap. Assets	None	3,843.80		3,843.80
Short Term—Ditto	4,154.07			4,154.07
Joint Ownership	7,950.15		7,950.15	None
Totals	31,009.38	3,843.80	7,950.15	26,903.03
Deductions:				
Contributions	4,194.97		159.52	4,035.45
Interest	1,207.50			1,207.50
Taxes	642.50			642.50
Total Deductions	6,044.97		159.52	5,885.45
Net Income				21,017.58

Page 2

Adjustments Explained—1947
Schedule 1-A

Item 4. Long Term Gains	3,843.80	
Previously Reported	None	
Adjustment		3,843.80
Item 6. Joint Ownership Income	None	
Previously Reported	7,950.15	
Adjustment		7,950.15

Contributions reduced because of 15% limitations.

Exhibit "B"—(Continued)

Page 3

Tax Computation—1947
Schedule 2

Net Income from Schedule No. 1	21,017.58	
Less: Exemptions (2)	1,000.00	
	20,017.58	
Combined Tentative Normal Tax and Surtax		7,269.84
Less: 5%		363.49
Corrected Assessment		6,906.35
Tax Assessed R.A.R. 9/15/50		9,062.05
Over Assessment Claimed		2,155.70

[Note: Exhibit A is the same as set out at pages 16-17.]

EXHIBIT "C"

CLAIM

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

(X) Refund of Taxes Illegally, Erroneously, or Excessively Collected.

* * * * *

State of Montana,
County of Flathead—ss.

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Business address: .....

Residence: 502 — 3rd Ave. East, Kalispell, Montana.

Exhibit "C"—(Continued)

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Helena, Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from 1/1, 1948, to 12/31, 1948.

3. Character of assessment or tax: Individual Income Tax.

4. Amount of assessment: $3,432.02; dates of payment: Quarterly 1948.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $1,088.12.

* * * * *

The deponent verily believes that this claim should be allowed for the following reasons:

As stated in Schedules and exhibits attached hereto and made a part of this claim as follows:

Schedule 1 .....Page 1
Schedule 1-A .....Page 2
Schedule 2 .....Page 3
Exhibit A .....Page 4

* * * * *

Exhibit "C"—(Continued)

CLAIM

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

(X) Refund of Taxes Illegally, Erroneously, or Excessively Collected.

* * * * *

State of Montana,
County of Flathead—ss.

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Business address: .....

Residence: 502 — 3rd Ave. East, Kalispell, Montana.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: Helena, Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from 1/1, 1949, to 12/31, 1949.

3. Character of assessment or tax: Individual Income Tax.

4. Amount of assessment: $3,167.10; dates of payment: Quarterly 1949.

5. Date stamps were purchased from the Government: .....

Exhibit "C"—(Continued)

6. Amount to be refunded: $1,050.50.

* * * * *

The deponent verily believes that this claim should be allowed for the following reasons: As stated in Schedules and exhibits attached hereto and made a part of this claim as follows:

Schedule 1.....Page 1
Schedule 1-A .....Page 2
Schedule 2 .....Page 3
Exhibit A .....Page 4

* * * * *

Thomas W. and Evelyn W. Elliot
502 — 3rd Avenue East
Kalispell, Montana

Adjustments—1949
Schedule 1

Income	Per Return As Filed	Additions	Deductions	Corrected
Wages	6,870.00			6,870.00
Dividends	3,889.60			3,889.60
Interest	1,537.59			1,537.59
Rentals	7,961.12		7,961.12	None
Net Gain—Capital Assets	1,044.00	3,845.80		4,887.80
Adjusted Gross Income	21,302.31	3,843.80	7,961.12	17,184.99
Deductions:				
Contributions	1,135.00			1,135.00
Interest	1,732.53			1,732.53
Taxes	946.14			946.14
Miscellaneous	7.20			7.20
	3,820.87			3,820.87
Net Income	17,481.44			13,364.12

Exhibit "C"—(Continued)

Adjustments Explained

Schedule 1-A

Item 4. Rentals Corrected	None
Reported	7,961.12
Adjustment	7,961.12

Gain on sale of property on installment basis as determined in Exhibit-A attached hereto, is based upon facts and interpretation of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiation, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of the ten-year period for $75,000.00, or a total of $265,000.00. Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Item 5. Gain on Capital Assets—Reported	1,044.00
Adjusted	4,887.80
Adjustment	3,843.80

See Explanation Above.

Item 4. Rentals Adjusted—Reported	7,961.12
Corrected	None

Gain on sale of property on installment basis as determined in Exhibit-A attached hereto, is based upon facts and interpretations of a lease and option drawn on February 1, 1946.

Property was offered for sale, for $265,000.00. After some negotiations, purchaser made a counter-offer as set out in the lease and option, to lease the property for ten years at $19,000.00 per year, with option to purchase the property at the end of the ten-year period for $75,000.00, or a total of $265,000.00. Purchaser agreed to pay taxes, insurance and maintenance. Transcript of agreement is attached hereto, as Exhibit A-1.

Item 5. Net Gain Capital Assets	
Reported	1,455.03
Corrected	5,298.83

See Explanation at Item 4.

Exhibit "C"—(Continued)

Tax Computation—1948

Schedule 2

Net Income Schedule No. 1		14,357.61
Less Exemptions (4)		2,400.00
Taxable Net Income		11,957.61
½ of above	5,978.81	
Combined Normal & Surtax	1,354.49	
Reduction	182.34	
	1,171.95	
2 x 1171.95=Tax Due		2,343.90
Previously assessed		3,432.02
Overassessment		1,088.12

Tax Computation—1949

Schedule 2

Net Income Schedule 1		13,364.12
Less Exemptions (4)		2,400.00
		10,964.12
½ of 10,964.12	5,482.06	
Combined Normal & Surtax on above	1,225.34	
Less 12% plus 68.00	167.04	
	1,058.30	
2 x 1058.30=Total Tax		2,116.60
Tax Paid		3,167.10
Overassessment		1,050.50

Exhibit "C"—(Continued)

Thomas W. and Evelyn W. Elliot
502 — 3rd Avenue East,
Kalispell, Montana

Item	Per Return as Filed	Adjustments—1948 Additions	Deductions	Correc
Income				
1. Salaries & Wages	6,659.36			6,659
2. Dividends	4,169.60			4,169
3. Interest	1,975.00			1,975
4. Rentals	7,961.12		7,961.12	
5. Net Gain—Capital Assets	1,455.03	5,843.80		5,298
6. Adjusted Gross Income	22,220.11	3,843.80	7,961.12	18,102
Deductions:				
7. Contributions	1,094.00			1,094
8. Interest	1,597.50			1,597
9. Taxes	1,046.48			1,046
10. Miscellaneous	7.20			7
	3,745.18			3,745
Net Income	18,474.93	3,843.80	7,961.12	14,357

EXHIBIT "D"

SUPPLEMENTAL REFUND CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Street address: 502 3rd Avenue North.

City, postal zone number, and State: Kalispell, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis,

Exhibit "D"—(Continued)

prepare separate form for each taxable year) from Jan. 1, 1949, to Dec. 31, 1949.

3. Kind of tax: Income.

4. Amount of assessment, $3167.10; dates of payment: by March 15, 1950.

* * * * *

6. Amount to be refunded: $3167.10, or such other amount as is legally refundable, plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

The claimant believes that this claim should be allowed for the following reasons:

The original refund claim previously filed claimed capital gain treatment on payments received from certain property, using the installment basis method of computing gain on the transaction.

This claim is filed to claim the right to exclude all payments received during 1949 on this transaction on the grounds that a sale occurred in 1946 and that payments received in subsequent years are not income.

For further details, reference is made to Revenue Agents Reports and other records on file with the Treasury Department.

Dated March 16, 1953.

/s/ THOMAS W. ELLIOT,
/s/ EVELYN W. ELLIOT.

EXHIBIT "E"

CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Street address: 502 Third Avenue North.

City, postal zone number, and State: Kalispell, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1950, to Dec. 31, 1950.

3. Kind of tax: Income.

4. Amount of assessment, Unknown; dates of payment: March 15, 1951; November 1951.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: Total tax paid or such other amount as is legally refundable, plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

Refund of the amount described on line 6 above is hereby demanded together with interest as provided by law.

Thomas W. Elliot, together with William G.

Exhibit "E"—(Continued)

Elliot, sold a business building located in Kalispell, Montana, to the F. A. Buttrey Company, a Montana corporation, on January 14, 1946. The sale price was payable, commencing on Feb. 1, 1946, at the rate of $19,000 a year for 10 years, at which time a final payment of $75,000 was payable unless the buyer elected not to make the final payment, in which event the deed to said property would be returned to the sellers.

The taxpayers erroneously reported on their 1950 U. S. Income Tax Return the yearly payment of $19,000 received in 1950 as rental income and paid tax thereon at ordinary income tax rate.

Under the Federal income tax law, a completed sale occurred in 1946 resulting in a long term capital gain. Therefore, all payments received during 1950 are not subject to Federal income taxation. For further details, the Revenue Agent's reports and other records and documents on file with the Treasury Department concerning the above taxpayers and involving the taxable years 1946, 1947, 1948, and 1949 are expressly incorporated herein by reference.

* * * * *

EXHIBIT "F"

CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Street address: 502 Third Avenue North.

City, postal zone number, and State: Kalispell, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1951, to Dec. 31, 1951.

3. Kind of tax: Income.

4. Amount of assessment, $2,850.84; dates of payment: March 15, 1952.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $2,850.84 or such amount as is legally refundable plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

The claimant believes that this claim should be allowed for the following reasons:

Refund of the amount described on line 6 above is hereby demanded together with interest as provided by law.

Exhibit "F"—(Continued)

Thomas W. Elliot, together with William G. Elliot, sold a business building located in Kalispell, Montana, to the F. A. Buttrey Company, a Montana corporation, on January 14, 1946. The sale price was payable, commencing on Feb. 1, 1946, at the rate of $19,000 a year for 10 years, at which time a final payment of $75,000 was payable unless the buyer elected not to make the final payment, in which event the deed to said property would be returned to the sellers.

The taxpayers erroneously reported on their 1951 U. S. Income Tax Return their share of the yearly payment of $19,000 received in 1951 as rental income and paid tax thereon at ordinary income tax rates.

Under the Federal income tax law, a completed sale occurred in 1946 resulting in a long term capital gain. For further details, the Revenue Agent's reports and other records and documents on file with the Treasury Department concerning the above taxpayers and involving the taxable years 1946, 1947, 1948, 1949, and 1950 are expressly incorporated herein by reference.

* * * * *

EXHIBIT "G"

CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Street address: 502 Third Avenue North.

City, postal zone number, and State: Kalispell, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1952, to Dec. 31, 1952.

3. Kind of tax: Income.

4. Amount of assessment, $2,814.04; dates of payment: March 15, 1953.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $2,814.04 or such amount as is legally refundable, plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

The claimant believes that this claim should be allowed for the following reasons:

Refund of the amount described on line 6 above is hereby demanded together with interest as provided by law.

Exhibit "G"—(Continued)

Thomas W. Elliot, together with William G. Elliot, sold a business building located in Kalispell, Montana, to the F. A. Buttrey Company, a Montana corporation, on January 14, 1946. The sale price was payable, commencing on Feb. 1, 1946, at the rate of $19,000 a year for 10 years, at which time a final payment of $75,000 was payable unless the buyer elected not to make the final payment, in which event the deed to said property would be returned to the sellers.

The taxpayers erroneously reported on their 1952 U. S. Income Tax Return their share of the yearly payment of $19,000 received in 1952 as rental income and paid tax thereon at ordinary income tax rates.

Under the Federal income tax law, a completed sale occurred in 1946 resulting in a long term capital gain. For further details, the Revenue Agent's reports and other records and documents on file with the Treasury Department concerning the above taxpayers, and involving the taxable years 1946, 1947, 1948, 1949, and 1950 are expressly incorporated herein by reference.

* * * * *

EXHIBIT "H"

CLAIM

* * * * *

Name of taxpayer or purchaser of stamps: Thomas W. and Evelyn W. Elliot.

Street address: 502 Third Avenue North.

City, postal zone number, and State: Kalispell, Montana.

1. District in which return (if any) was filed: Montana.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from Jan. 1, 1953, to Dec. 31, 1953.

3. Kind of tax: Income.

4. Amount of assessment, $3,004.94; dates of payment: March 15, 1954.

5. Date stamps were purchased from the Government: .....

6. Amount to be refunded: $3,004.94 or such amount as is legally refundable plus interest.

7. Amount to be abated (not applicable to income, estate, or gift taxes): .....

The claimant believes that this claim should be allowed for the following reasons:

Refund of the amount described on line 6 above is hereby demanded together with interest as provided by law.

Exhibit "H"—(Continued)

Thomas W. Elliot, together with William G. Elliot, sold a business building located in Kalispell, Montana, to the F. A. Buttrey Company, a Montana corporation, on January 14, 1946. The sale price was payable, commencing on Feb. 1, 1946, at the rate of $19,000 a year for 10 years, at which time a final payment of $75,000 was payable unless the buyer elected not to make the final payment, in which event the deed to said property would be returned to the sellers.

The taxpayers erroneously reported on their 1953 U. S. Income Tax Return their share of the yearly payment of $19,000 received in 1953 as rental income and paid tax thereon at ordinary income tax rates.

Under the Federal income tax law, a completed sale occurred in 1946 resulting in a long term capital gain. For further details, the Revenue Agent's reports and other records and documents on file with the Treasury Department concerning the above taxpayers and involving the taxable years 1946, 1947, 1948, 1949, and 1950 are expressly incorporated herein by reference.

* * * * *

[Exhibit I—Lease Agreement and Purchase Option dated January 14, 1946, is the same as Exhibit K set out in Case No. 15983 at page 41.]

[Exhibit J—Memorandum Agreement dated February 1, 1946, is the same as Exhibit L set out in Case No. 15983 at page 54.]

EXHIBIT "K"

AFFIDAVIT AND STATEMENT BY SELLER TO PURCHASER UNDER BULK SALES LAW

State of Montana,
County of Flathead—ss.

T. W. Elliot, being first duly sworn on oath, deposes and says: That he is the President of the Flathead Commercial Company, a Montana corporation, which has been and is now conducting a dry goods and clothing business in the Buffalo Block on Main Street in the City of Kalispell, Flathead County, Montana, on Lots Ten (10), Eleven (11) and Twelve (12) of Block Fifty-five (55) of the original townsite of Kalispell; that in connection with the conduct of said store and business said corporation has carried a stock of merchandise and furnishings; that said Flathead Commercial Company, a corporation, has made and entered into an Agreement for the sale of all stock in trade and merchandise of said business, and that affiant makes this affidavit as President of said corporation, being thereunto duly authorized, and in compliance with the provisions of what is known as the Bulk Sales Law of the State of Montana, and particularly Section 8607, Revised Codes of Montana of 1935. That in compliance with said Law this affiant hereby certifies and declares that there are no creditors of said Flathead Commercial Company holding claims due or owing or which

Exhibit "K"—(Continued)

shall become due or owing for or on account of goods, wares, merchandise, trade fixtures, or equipment purchased upon credit, and that there are no creditors of the vendor, Flathead Commercial Company, holding any claims due or owing or which shall become due or owing for or on account of money borrowed by said Flathead Commercial Company and used in the business of said Company; and this affiant, as such officer of said corporation, hereby expressly certifies that all stocks of merchandise, fixtures and equipment now situated on said premises above referred to and covered by said sales agreement with F. A. Buttrey Company, a Montana corporation, are free of any creditors' claims whatsoever.

/s/ T. W. ELLIOT.

Subscribed and sworn to before me this 31st day of January, 1946.

[Seal] DANIEL J. KORN,

Notary Public for the State of Montana. Residing at Kalispell, Montana. My Commission Expires Sept. 22, 1946.

[Endorsed]: Filed May 25, 1955.

[Title of District Court and Cause No. 1728.]

ANSWER

Comes now the defendant, by his attorney of record, Krest Cyr, United States Attorney for the District of Montana, and in answer to plaintiffs' complaint herein:

A. Denies every allegation not admitted, qualified or otherwise specifically referred to below.

B. Further answering the petition:

1. Denies the allegations in paragraph 1 except those relating to the provisions of Section 322 of the Internal Revenue Code of 1939 admitted in other numbered paragraphs to follow.

2. Admits the allegations in paragraph 2.

3. Admits the allegations in paragraph 3.

4. Denies the allegations in paragraph 4.

5. Admits the allegations in the first sentence of paragraph 5 and denies the remaining allegations therein except to admit that the plaintiffs paid on or before March 15, 1947, the amount of $7,200 and to allege that the balance of the amount of $7,350.69 was paid on March 17, 1947. Defendant further alleges that $2,264.59 of the amount of $7,350.69, with interest of $555.94, a total of $2,820.53, has been repaid to the plaintiffs by statutory credit and by Treasury check.

6. Denies the allegations in paragraph 6 except to admit that on March 15, 1951, the plaintiffs filed

with the defendant a claim for refund of $2,472.01 income tax paid for the year 1946 of which Exhibit "A" is a partial but incomplete copy, and also denies any allegations in such claim for refund not elsewhere herein admitted.

7. Admits the allegations in the first sentence of paragraph 7; admits the allegations in the second sentence of paragraph 7 except to allege that $7,200 was paid on or before March 15, 1948, and the balance of $1,168.55 was paid on April 26, 1948; and denies the allegations in the third sentence of paragraph 7 except to admit that a deficiency in income tax for the calendar year 1947 was assessed on October 26, 1950, in the sum of $384.69 as tax with interest thereon of $59.82, a total of $444.51, which was collected by a statutory credit of an overpayment by the plaintiffs upon their 1946 income tax return.

8. Admits the allegations in paragraph 8 except to deny that Exhibit "B" is a complete copy of the original claim for refund and also to deny all allegations in the claim not elsewhere herein admitted.

9. Admits the allegations in paragraph 9 except to allege that the plaintiffs paid on March 16, 1948, only a net amount of $3,432.02.

10. Denies the allegations in paragraph 10 except to admit that on April 5, 1951, the plaintiffs filed a claim for refund of $1,088.12 income tax paid for the year 1948 and to admit that Exhibit "C" is an incomplete copy of such claim for refund and also

denies all allegations in such claim for refund not elsewhere herein admitted.

11. Admits the allegations in paragraph 11 except to allege that the plaintiffs paid on or before March 15, 1950, a net amount of only $2,191.50 as federal income tax for 1949.

12. Admits the allegations in paragraph 12 except to deny that Exhibit "C" and Exhibit "D" are complete copies of the original claims, to deny all allegations in such claims for refund not elsewhere herein admitted and also to deny that the claim for refund of $3,167.10 filed March 16, 1953, was an "amended" claim for refund.

13. Admits the allegations in paragraph 13 except to allege that the plaintiffs paid on or before March 15, 1951, the amount of $4,127.26 and to allege that they paid deficiency interest of only $122.20.

14. Admits the allegations in paragraph 14 except to allege that the sum of $6,920.92 in fact was only $5,636.16 or the "total tax paid"; denies that Exhibit "E" is a complete copy of the original claim for refund and also denies all allegations in such claim not elsewhere herein admitted.

15. Denies the allegations in paragraph 15 except to admit that the plaintiffs filed their federal income tax return for the calendar year 1951 with the defendant on March 17, 1952, at which time they made a payment of $1,517.44 in addition to a prior payment of $660, an aggregate payment of $2,177.44.

16. Admits the allegations in paragraph 16 except to deny that Exhibit "F" is a complete copy of the original claim for refund and also to deny all allegations in such claim not elsewhere herein admitted.

17. Admits the allegations in paragraph 17.

18. Admits the allegations in paragraph 18 except to deny that Exhibit "G" is a complete copy of the original claim for refund and also to deny all allegations in such claim not elsewhere herein admitted.

19. Admits the allegations in paragraph 19.

20. Admits the allegations in paragraph 20 except to deny that Exhibit "H" is a complete copy of the original claim for refund and also to deny all allegations in such claim not elsewhere herein admitted.

21. Admits the allegations in the first sentence of paragraph 21 and denies the remaining allegations in such paragraph.

22. Denies the allegations in the first sentence of paragraph 22 and is without knowledge or information sufficient to form a belief as to the truth of the remaining allegations in such paragraph, including the allegations relating to Exhibits "I" and "J".

23. Denies the allegations in paragraph 23 except to admit that the plaintiffs received an amount of $9,000 in 1946.

24. Denies the allegations in paragraph 24.

25. Is without knowledge or information sufficient to form a belief as to the truth of the allegations in paragraph 25 and is without knowledge or information relating to Exhibit "K".

26. Denies the allegations in paragraph 26.

27. Admits the allegations in paragraph 27.

28. Denies the allegations in paragraph 28 except to admit that the plaintiffs received $9,000 in 1947.

29. Denies the allegations in paragraph 29.

30. Admits the allegations in the first sentence of paragraph 30 and denies the remaining allegations in such paragraph.

31. Denies the allegations in paragraph 31 except to admit that the plaintiffs received $9,000 in 1948.

32. Denies the allegations in paragraph 32.

33. Admits the allegations in the first sentence of paragraph 33 and denies the remaining allegations in such paragraph.

34. Denies the allegations in paragraph 34 except to admit that the plaintiffs received $9,000 in 1949.

35. Denies the allegations in paragraph 35.

36. Admits the allegations in paragraph 36 and also alleges that the claims for refund for the years 1950, 1951, 1952 and 1953 were disallowed with statutory notice dated July 5, 1955.

37. Denies the allegations in paragraph 37 except to admit that the plaintiffs received $9,000 in each of the years 1950, 1951, 1952 and 1953.

38. Denies the allegations in paragraph 38 except to admit that no part of the amounts therein set forth has been refunded or credited except as shown in preceding numbered paragraphs of this answer.

Affirmative Defense

39. Plaintiffs timely filed a claim for refund of $2,155.70 of income tax paid for the calendar year 1947. Such claim was disallowed in full. Notice of such disallowance was given to the plaintiffs by the Commissioner of Internal Revenue by registered mail on July 20, 1951. More than two years from the date of mailing by registered mail of such notice of disallowance on July 20, 1951, had expired before the plaintiffs on May 27, 1955, filed their complaint and summons in the above-entitled suit. Plaintiffs' suit was begun after any recovery upon their claim for refund for 1947 was barred by provisions in Section 6532(a), Internal Revenue Code of 1954. The Court has no jurisdiction except to dismiss the pending action in so far as it relates to plaintiffs' asserted claim for the calendar year 1947.

40. The Court is requested to order a reply to the affirmative defense in paragraph 39 of this answer, as provided in Rule 7(a).

Wherefore, defendant demands judgment that

plaintiffs' complaint be dismissed, together with the costs of this action.

KREST CYR,
United States Attorney, Attorney for the defendant.

/s/ FRANK M. KERR,
Assistant United States Attorney.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed October 5, 1955.

[Title of District Court and Cause No. 1728.]

AMENDMENT TO COMPLAINT

Plaintiffs, by their attorneys, for their amendment to their complaint herein allege:

1. Paragraph (22) of the Complaint is amended so that, as amended, it shall read exactly as now written with the addition of the following sentence at the end thereof: On or about November 5, 1955, the above-mentioned F. A. Buttrey Company, elected to make the agreed payment of $75,000.00 and said sum was paid to the plaintiffs and to William G. Elliot.

2. Paragraph (30) of the Complaint is amended so that, as amended, it shall read as follows: The Commissioner of Internal Revenue has taken no action on the 1948 refund claim to the best of the plaintiffs' information and belief. This Complaint

is filed after the expiration of six months from the date of filing the 1948 refund claim.

3. Paragraph (15) of the Complaint is amended by striking out the figure $2,850.84 and replacing it with the figure $3,510.84 and striking out all of the words written after that figure.

4. Paragraph (16) of the Complaint is amended by striking out the figure $2,850.84 and replacing it with the figure $3,510.84.

5. Paragraph (24) of the Complaint is amended by striking out the figure $19,321.63 and replacing it with the figure $20,321.63.

Dated, June 15, 1956.

FELT, FELT & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiffs.

[Endorsed]: Filed June 15, 1956.

[Title of District Court and Cause No. 1728.]

STIPULATION OF FACTS

1. This action is instituted pursuant to the provisions of Section 322 of the Internal Revenue Code of 1939 (U. S. C. Title 26, Sec. 322) for the recovery of Federal income taxes and interest thereon, paid for the calendar years 1946, 1947, 1948, 1949, 1950, 1951, 1952, and 1953.

2. The plaintiffs are husband and wife, residing at 502 Third Avenue East, Kalispell, Montana, and they are residents of the District of Montana.

3. This action against Thomas M. Robinson, U. S. District Director of Internal Revenue, arises under the Act of June 25, 1948, 62 Stat. 932, United States Code, Title 28, Sec. 1340.

4. The plaintiffs duly filed their Federal income tax return for the calendar year 1946 with the above-named defendant. The plaintiffs paid, on or before March 15, 1947, the amount of $9,150.69. $2,264.59 of the amount of $9,150.69, with interest of $555.94, a total of $2,820.53, has been repaid to the plaintiffs by statutory credit and by Treasury check resulting in a net payment of tax of $6886.10.

5. The plaintiffs filed with the defendant, a claim for refund of $2,472.01 income tax paid for the year 1946. A true copy of said claim for refund is attached to the complaint and marked Exhibit "A", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case. Said claim for refund was filed on March 15, 1951, and therefore was not filed within the time limit required by Section 322(b) of the 1939 Internal Revenue Code.

6. The plaintiffs duly filed their Federal income tax return for the calendar year 1947 with the above-named defendant. The plaintiffs paid, on or before March 15, 1948, an amount of $7,200.00 and on April 26, 1948 they paid $1,168.55, a total of $8,368.55, the Federal income tax for 1947 shown to be due by said return. On October 26, 1950, a deficiency in income tax for the calendar year 1947 was assessed by the above-named defendant in the

sum of $384.69, together with interest thereon of $59.82, a total of $444.51 which was collected on said date by a statutory credit of an overpayment by the plaintiffs upon their 1946 Federal income tax return.

7. On or before March 15, 1951, the plaintiff duly filed with the defendant a timely claim for refund of $2,155.70, income tax paid for the year 1947. A true copy of said claim for refund is attached to the complaint and marked Exhibit "B", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

8. The plaintiffs duly filed their Federal income tax return for the calendar year 1948 with the above-named defendant. The plaintiffs paid, on or before March 15, 1949, the amount of $3,432.02.

9. On or before March 15, 1952, the plaintiffs duly filed with the defendant a timely claim for refund of $1,088.12, income tax paid for the year 1948. A true copy of said claim for refund is attached to the complaint and marked Exhibit "C", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

10. The plaintiffs duly filed their Federal income tax return for the calendar year 1949 with the above-named defendant. The plaintiffs paid, on or before March 15, 1950, the amount of $3,167.10, the Federal income tax for 1949 shown to be due by said return.

11. On or before April 5, 1951, the plaintiffs duly filed with the defendant a timely claim for refund of $1,050.50, income tax paid for the year 1949. A true copy of said claim for refund is attached to the complaint and marked Exhibit "C", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case. On March 16, 1953, the plaintiffs filed with the defendant another claim for refund of $3,167.10, income tax paid for the year 1949. Plaintiffs assert that this second claim is amendatory to the first claim. Defendant denies that it is an amended claim. A true copy of said claim for refund is attached to the Complaint and marked Exhibit "D", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

12. The plaintiffs duly filed their Federal income tax return for the calendar year 1950 with the above-named defendant. The plaintiffs paid, on or before March 15, 1951, the amount of $5,412.02, the Federal income tax for 1950 shown to be due by said return. On or about October 4, 1951, pursuant to a notice and demand received from the above-named defendant, the plaintiffs paid a deficiency in income tax for the calendar year 1950 in the amount of $1,508.90, together with interest thereon of $122.20, said payments being made to the above-named defendant.

13. On or before March 15, 1954, the plaintiffs duly filed with the defendant a timely claim for

refund of $6,920.92, income tax paid for the year 1950. A true copy of said claim for refund is attached to the complaint and marked Exhibit "E", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

14. The plaintiffs duly filed their Federal income tax return for the calendar year 1951 with the above-named defendant. The plaintiffs paid, on or before March 15, 1952, the amount of $3510.84, as Federal income tax paid for 1951.

15. On or about July 9, 1954, the plaintiffs duly filed with the defendant a timely claim for refund of $3510.84, income tax paid for the year 1951. A true copy of said claim for refund is attached to the complaint and marked Exhibit "F", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

16. The plaintiffs duly filed their Federal income tax return for the calendar year 1952 with the above-named defendant. The plaintiffs paid on or before March 15, 1953, the amount of $2,814.04, the Federal income tax for 1952 shown to be due by said return.

17. On or about July 8, 1954, the plaintiffs duly filed with the defendant a timely claim for refund of $2,814.04, income tax paid for the year 1952. A true copy of said claim for refund is attached to the complaint and marked Exhibit "G", except that

such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

18. The plaintiffs duly filed their Federal income tax return for the calendar year 1953 with the above-named defendant. The plaintiffs paid, on or before March 15, 1954, the amount of $3,004.94, the Federal income tax for 1953 shown to be due by said return.

19. On or about July 8, 1954, the plaintiffs duly filed with the defendant a timely claim for refund of $3,004.94, income tax paid for the year 1953. A true copy of said claim for refund is attached to the complaint and marked Exhibit "H", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

20. The Commissioner of Internal Revenue disallowed the claims for refund for 1949, 1950, 1951, 1952, and 1953. The complaint in this case was filed within two years of the time of the receipt of all of the statutory disallowances of the aforesaid refund claims.

21. The plaintiffs received $9,000 in each of the years 1946 through and including 1953 under the "Lease Agreement and Purchase Option." Said amounts were reported and taxed as ordinary rental income in the plaintiffs' Federal income tax returns for each of those years.

22. Prior to entering into the "Lease Agreement

and Purchase Option", the plaintiffs owned an undivided one-half interest in the property described therein. Said property had been held by the plaintiffs for more than six months. The plaintiffs' adjusted basis for determining gain under the Internal Revenue Code of 1939 with respect to said property was $20,321.63 on January 14, 1946.

23. If the Court holds that the "Lease Agreement and Purchase Option" constitutes, for Federal income tax purposes, a sale or a conditional sale, then in order to conserve the time of the Court it is further stipulated that the parties will submit computations of amounts of over-payment to be entered for the respective years as judgment for plaintiffs, and if the computations submitted by the parties differ in amount, the parties shall be afforded an opportunity to be heard in an argument on the date fixed by the Court and thereafter the Court will then determine the correct overpayment and enter its decision.

It is understood and agreed that any argument as to the correct computation of any overpayment shall be strictly confined to the consideration of the correct computation and shall not be used for the purpose of affording an opportunity for rehearing or reconsideration.

24. If the Court holds that the "Lease Agreement and Purchase Option" does not constitute, for Federal income tax purposes, a sale or a conditional sale, then it is further stipulated that the defendant is entitled to a judgment that the plain-

tiffs' complaint be dismissed, together with the costs of the action.

Dated June 15, 1956.

FELT, FELT, & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiffs.

KREST CYR,
U. S. Attorney,
/s/ By DALE F. GALLES,
Attorney for Defendant.

[Endorsed]: Filed June 15, 1956.

[Title of District Court and Cause No. 1728.]

AMENDMENT TO THE STIPULATION OF FACTS

Paragraph 5 of the Stipulation of Facts is hereby amended to read as follows:

5. The plaintiffs filed with the defendant, a timely claim for refund of $2,472.01 income tax paid for the year 1946. A true copy of said claim for refund is attached to the complaint and marked Exhibit "A", except that such copy is incomplete by reason of omission of signatures and date and it is sufficient for purposes of this case.

Paragraph 20 of the Stipulation of Facts is hereby amended to read as follows:

20. The Commissioner of Internal Revenue disallowed the claims for refund for 1946, 1949, 1950,

1951, 1952, and 1953. The complaint in this case was filed within two years of the time of the receipt of all of the statutory disallowances of the aforesaid refund claims.

Dated August 6, 1956.

FELT, FELT, & BURNETT,
/s/ By JACK W. BURNETT,
Attorneys for Plaintiffs.
KREST CYR,
U. S. Attorney,
/s/ By DALE F. GALLES,
Attorney for Defendant.

[Endorsed]: Filed August 7, 1956.

[Title of District Court and Cause No. 1728.]

NOTICE OF APPEAL

Notice is hereby given that Thomas M. Robinson, the defendant named above, hereby appeals to the United States Court of Appeals for the Ninth Circuit from a decision of Judge Charles N. Pray in an opinion filed June 27, 1957.

KREST CYR,
United States Attorney,
/s/ DALE F. GALLES,
Assistant United States Attorney,
Attorneys for Defendant.

[Endorsed]: Filed August 26, 1957.

[Title of District Court and Cause No. 1728.]

ORDER

Pursuant to the Application for Extension of Time of defendant, the United States of America, to perfect and docket the record on appeal herein, and good cause appearing therefor,—

It Is Now Ordered that the time within which the defendant may perfect and docket its appeal herein be, and hereby is, extended for a period of fifty (50) days.

Dated this 4th day of October, 1957.

/s/ W. J. JAMESON,
United States District Judge.

[Endorsed]: Filed October 4, 1957. Entered October 7, 1957.

In the United States District Court, District of Montana, Billings Division

Civil No. 1728

THOMAS W. ELLIOT and EVELYN W. ELLIOT, Plaintiffs,

vs.

THOMAS M. ROBINSON, Defendant.

JUDGMENT

This cause came on regularly to be heard on the 15th day of June, 1956. The plaintiffs appeared by

their attorneys, Messrs. James R. Felt and Jack W. Burnett, also Jerome Anderson. Plaintiff Thomas W. Elliot also appeared in person. The defendant appeared by his attorneys, Dale Galles, Assistant United States Attorney, and John A. Rees, Special Assistant to the Attorney General. Evidence, both oral and written, was submitted. Within the time allowed therefor all parties filed typewritten briefs, requested Findings of Fact, and Conclusions of Law. The Court, being fully advised in the premises, made and filed a typewritten Opinion, Findings of Fact, and Conclusions of Law.

Now, therefore, in accordance with such Findings, Conclusions, and Opinion heretofore entered and filed,

It is Ordered, Adjudged, and Decreed that the plaintiffs, Thomas W. and Evelyn W. Elliot, have and recover judgment against the defendant, Thomas M. Robinson, in the sum of $10,436.72 with interest thereon as provided by law, and their costs allowed by law.

Done this 31st day of October, 1957.

/s/ CHARLES N. PRAY,
United States District Judge.

[Endorsed]: Filed and Entered October 31, 1957.

[Title of District Court and Cause No. 1728.]

CERTIFICATE OF PROBABLE CAUSE

Under authority provided in 28 U.S.C. 2006, pursuant to Rule 69(b) of the Federal Rules of Civil Procedure, the Court finds that the defendant as District Director of Internal Revenue acted under the direction of the Commissioner of Internal Revenue and upon probable cause in the collection of taxes found to be due and owing from him to the plaintiffs in the above-entitled action for which a judgment has been entered. A certificate of probable cause should therefore be granted.

Wherefore, it is ordered that a certificate of probable cause be and the same hereby is issued and entered in the above-entitled action and the defendant, Thomas M. Robinson, District Director of Internal Revenue for the Collection District of Montana, is hereby ordered relieved from the payment of said judgment and it is ordered paid out of the proper appropriation from the United States Treasury.

/s/ CHARLES N. PRAY,
United States District Judge.

[Endorsed]: Filed October 31, 1957.

[Title of District Court and Cause No. 1728.]

NOTICE OF APPEAL

Notice is hereby given that Thomas M. Robinson, the defendant named above, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the Judgment of the above-entitled Court filed October 31, 1957.

KREST CYR,
United States Attorney,
/s/ DALE F. GALLES,
Assistant U. S. Attorney, Attorneys for Defendant.

[Endorsed]: Filed December 30, 1957.

[Title of District Court and Cause No. 1728.]

ORDER

Pursuant to the Application for Extension of Time of defendant, Thomas M. Robinson, ex parte, to file and docket the record on appeal herein, and good cause appearing therefor,——

It Is Now Ordered that the time within which the defendant may file and docket its record on appeal herein be, and hereby is, extended for a period of fifty (50) days, from the date hereof, pursuant to Rule 73(g) of the Federal Rules of Civil Procedure.

Dated this 7th day of February, 1958.

/s/ W. J. JAMESON,
United States District Judge.

[Endorsed]: Filed February 7, 1958.

[Title of District Court and Cause No. 1728.]

DOCKET ENTRIES

1955

May 25—Filed Complaint.

May 27—Issued Summons and 3 copies—Mailed to Marshal at Butte.

Jun. 29—Filed Summons—Served June 20th and 24th.

Aug. 4—Filed Stipulation granting defendant 60 days additional time to plead.

Aug. 6—Filed and entered Order granting defendant 60 days additional time to plead.

Oct. 5—Filed Answer of Defendant.

Dec. 13—Filed Plaintiff's Motion for a pre-trial conference.

1956

Jun. 1—Entered Order Motion granted.

Jun. 1—Entered Order case noted for trial.

Jun. 6—Entered Order case set for pre-trial conference, and for trial, on June 15, 1956, 10 A.M.

Jun. 15—Filed Consolidation for trial, with case #1727.

Jun. 15—Entered Order consolidating this case for trial with case #1727.

Jun. 15—Filed Amendment to complaint.

Jun. 15—Filed Stipulation of documentary evidence.

Jun. 15—Filed Stipulation of facts.

1956

Jun. 15—Entered record of trial, 60 days for Plaintiff's brief, 30 days for defendant's brief, and 20 days for reply brief.

July 30—Filed Reporters notes for this case and case #1727.

July 30—Filed Reporters Transcript for this case and case #1727.

Aug. 7—Filed Amendment to the Stipulation of Facts.

Nov. 28—Entered Order extending time to Dec. 31, 1956 for filing of Plaintiff's Brief.

Dec. 22—Filed Plaintiff's Brief.

1957

Feb. 9—Filed Stipulation in Case 1727, to apply herein, for correction of transcript.

Feb. 19—Filed Defendant's Brief in case #1727, to apply herein.

Feb. 19—Filed Affidavit of service by mail.

Mar. 12—Filed Reply Brief for Plaintiffs.

Mar. 12—Filed Affidavit of Service by mail.

Apr. 26—Filed Brief of Defendant in Rebuttal (Placed in file #1727).

Apr. 26—Filed Certificate of Mailing.

Jun. 27—Filed Opinion and Order therein, ruling in favor of Plaintiffs.

Jun. 27—Entered Order for Judgment, etc., to be rendered in favor of Plaintiffs.

Jun. 27—Mailed copy Opinion to Felt, Felt & Burnett, Billings, Mont., and U. S. Attorney, Billings, Mont.

1957

Aug. 26—Filed Notice of Appeal by Defendant.

Aug. 28—Mailed copy Notice of Appeal to counsel for plaintiffs.

Oct. 4—Filed Application for extension of time to docket record on appeal, for 50 days.

Oct. 4—Filed Order extending time for 50 days to docket record on appeal.

Oct. 7—Entered and noted herein Order extending time for 50 days to docket record on appeal.

Oct. 31—Defendant's proposed Findings of Fact and Conclusions of Law lodged with Clerk.

Oct. 31—Stipulation of amounts of overpayments, filed in case #1727, William G. Elliot vs. Thomas M. Robinson, to also apply herein.

Oct. 31—Findings of Fact and Conclusions of Law, filed in Case No. 1727, William G. Elliot vs. Thomas M. Robinson, to also apply herein.

Oct. 31—Filed & entered Judgment for Plaintiffs and against defendant for $10,436.72, with interest and costs.

Oct. 31—Mailed notice of entry of Judgment to all counsel herein.

Oct. 31—Filed Certificate of probable cause.

Oct. 31—Filed Judgment Roll.

Dec. 30—Filed Defendant's notice of appeal.

1958

Feb. 7—Filed Defendant's application for extension of time to docket record on appeal.

Feb. 7—Filed Order granting defendant 50 days additional time to docket record on appeal.

Feb. 10—Entered Order granting defendant 50 days additional time to docket record on appeal.

Mar. 25—Filed Stipulation as to contents of record on appeal (see case #1727).

Mar. 26—Mailed Record on Appeal to Clerk U. S. Court of Appeals, San Francisco, Calif., from Clerk's office at Billings, Mont.

Apr. 8—Filed Supplemental Stipulation as to Record on Appeal for this case and case #1727.

[Endorsed]: No. 15984. United States Court of Appeals for the Ninth Circuit. Thomas M. Robinson, Appellant, vs. Thomas W. Elliot and Evelyn W. Elliot, Appellees. Transcript of Record. Appeal from the United States District Court for the District of Montana.

Filed: March 28, 1958.

Docketed: April 10, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15984

THOMAS M. ROBINSON, Appellant,

vs.

THOMAS W. ELLIOT and EVELYN W. ELLIOT, Appellees.

STATEMENT OF POINTS UPON WHICH DEFENDANT-APPELLANT INTENDS TO RELY

The District Court erred in the following respects:

I.

In concluding and holding in the opinion that the plaintiffs made a sale of their property to the Buttrey Company in 1946 or at any time prior to 1955; that it was so understood by both parties; and that the annual rentals, so called, were installment payments on the purchase price.

II.

In making findings of fact numbered 15, 16, 17 and 18, the last sentence in finding 11, also in not finding as a fact or concluding as a matter of law that:

a. The parties, and certainly the purchaser, did not intend to make an agreement of immediate sale in 1946;

b. No conditional sale was made;

c. The Buttrey Company was not obligated to buy the property, and it acquired no equity in such property until 1955 when the option was exercised;

d. The return as ordinary rental income by the plaintiffs-appellees of the payments which they received from the Buttrey Company bars their claims that such income should be treated as gain from the sale of a capital asset;

e. The complaints did not predicate any recovery upon an alleged sale in 1946 at a profit taxable in that year as capital gain;

f. The plaintiffs-appellees offered no proof, and there is no evidence of record, to show any promise by the Buttrey Company which had a fair market value in 1946; and

g. The absence of any proof of an election by the plaintiffs-appellees to report gain from a sale upon the installment basis precludes any capital gain treatment for years after 1946.

III.

In making conclusions of law numbered 1, 2, 3 and 4, also in not concluding and holding that formal claims for refund, Exhibits H, I and J attached to the complaint in Civil No. 1727, also Exhibits E, F, G and H attached to the complaint in Civil No. 1728, each set forth a ground at variance with and wholly different from the ground of the claim for recovery in such complaints, and that such variance

deprived the Court of jurisdiction for the years 1951 to 1953, both inclusive, in Civil No. 1727, also for the years 1950 and 1953, both inclusive, in Civil No. 1728.

IV.

In not entering judgments in defendant-appellant's favor and against the plaintiffs-appellees.

Dated: April 7, 1958.

KREST CYR,
United States Attorney for the District of Montana.

/s/ DALE F. GALLES,
Assistant U. S. Attorney for the District of Montana. Attorneys for Defendant-Appellant.

Acknowledgment of Service Attached.

[Endorsed]: Filed April 10, 1958. Paul P. O'Brien, Clerk.

Nos. 15983 and 15984

In the United States Court of Appeals for the Ninth Circuit

THOMAS M. ROBINSON, APPELLANT

v.

WILLIAM G. ELLIOT, APPELLEE

THOMAS M. ROBINSON, APPELLANT

v.

THOMAS W. ELLIOT AND EVELYN W. ELLIOT, APPELLEES

On Appeals from the Judgments of the United States District Court for the District of Montana

BRIEF FOR THE APPELLANT

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Assistant Attorney General.

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KREST CYR,
United States Attorney.

DALE F. GALLES,
Assistant United States Attorney.

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In the United States Court of Appeals
for the Ninth Circuit

No. 15983

THOMAS M. ROBINSON, APPELLANT

v.

WILLIAM G. ELLIOT, APPELLEE

No. 15984

THOMAS M. ROBINSON, APPELLANT

v.

THOMAS W. ELLIOT AND EVELYN W. ELLIOT, APPELLEES

On Appeals from the Judgments of the United States District Court for the District of Montana

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BRIEF FOR THE APPELLANT

OPINION BELOW

The opinion, findings of fact and conclusions of law of the District Court (No. 15983, R. 73-79, 81-88),[1] are not officially reported.

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[1] The above entitled cases were consolidated for trial. (No. 15983, R. 64, 106.) On this appeal the basic record in each case is printed separately (No. 15983, pp. 1-103 and No. 15984, pp. 1-64) as Volume I, and the transcript of proceedings in the District Court is printed as Volume II of both proceedings. Record references herein to the separate Volume I in each case will be so indicated.

JURISDICTION

These appeals are from judgments entered by the District Court of Montana (No. 15983, R. 89-90; No. 15984, R. 54-55) in separate suits brought by William G. Elliot (No. 15983, R. 3-12), and by Thomas W. Elliot and his wife (No. 15984, R. 3-12), herein sometimes referred to as the taxpayers, against Thomas M. Robinson, District Director of Internal Revenue for the District of Montana (No. 15983, R. 66, 81; No. 15984, R. 46), for recovery of amounts allegedly overpaid as federal income taxes for the taxable years 1946 through 1953, both inclusive, in the aggregate amounts of $18,658.86 (No. 15983, R. 11-12) and $17,657.86 (No. 15984, R. 11-12), respectively. Each suit was based upon separate refund claims filed by the respective taxpayers for each of the years involved. (No. 15983, R. 12-41; No. 15984, R. 12-35.) In No. 15983 it was stipulated by the parties (R. 66) that the refund claim filed by William G. Elliot for the year 1946 was not filed within the time limit required by Section 322(b) of the Internal Revenue Code of 1939, but that the claims filed by William G. Elliot for the years 1947 through 1953, both inclusive, were timely (R. 67-71), and that the complaint in his case was filed within two years of the taxpayer's receipt of the Commissioner's statutory notice of disallowance of his claims for the latter years (R. 71-72). In No. 15984 it was stipulated by the parties that refund claims for each of the years 1946 through 1953 were timely filed by the taxpayers (R. 46-50, 52), and that the complaint in that case was filed in that case within two years

of the time of receipt by the taxpayers of statutory notices of disallowance of the claims for 1946, 1949, 1950, 1951, 1952, and 1953 (R. 50, 52-53). The suits were consolidated for trial (No. 15983, R. 64), and were submitted to the District Court on stipulations of fact, documentary evidence, and oral testimony (No. 15983, R. 65-73, 113-150; No. 15984, R. 45-53, 113-150), on the basis of which the District Court made findings of fact and conclusions of law (No. 15983, R. 81-88), and entered judgment in each case under date of October 31, 1957 (No. 15983, R. 89-90; No. 15984, R. 54-55).[2] The cases are before this Court pursuant to notices of appeal filed on behalf of the District Director of Internal Revenue on December 30, 1957. (No. 15983, R. 92; No. 15984, R. 57).[3] The jurisdiction of this Court is invoked under 28 U.S.C., Section 1291.

QUESTIONS PRESENTED

The question on the merits presented by these appeals is whether a transaction evidenced by a written "Lease Agreement and Purchase Option" executed

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[2] The judgments, as to amounts and periods for which recovery was allowed, were based upon agreements of the parties, and do not include any amount as refundable to William G. Elliot for 1946, or any amount as refundable to Thomas W. Elliot and his wife for 1946 or 1947. (No. 15983, R. 72, 87; No. 15984, R. 51.)

[3] The District Court's opinion (No. 15983, R. 73-79) was filed June 27, 1957, prior to the Supreme Court's decision in *United States* v. *Schaefer Brewing Co.*, 356 U.S. 227, and protective notices of appeal also were filed on behalf of the District Director on August 26, 1957 (No. 15983, R. 80; No. 15984, R. 53).

under date of January 14, 1946, supplemented by a Memorandum Agreement dated February 1, 1946, constituted a conditional sale of real property the gain from which may be reported on the installment basis for income tax purposes, as held by the District Court, or whether annual payments received under that contract represented rental income as reported by the taxpayers.

Before reaching the question on the merits, however, two preliminary questions should be resolved by this Court. Assuming arguendo, but without conceding, that the transaction constituted an installment sale of real property, the further questions presented on the record are:

1. Whether the taxpayers, having reported payments received under the contract as rental income, may later avail themselves of the installment provisions of the statute by filing refund claims and bringing suit on that basis for recovery of a part of the taxes paid.

2. Whether, as to some of the years involved, the District Court may entertain suits for recovery based on the ground that the taxpayers were entitled to have their taxes computed by the installment method whereas the refund claim for those years were based on the ground that gain from the alleged sale of property was taxable in the year of sale and no part of the payments received in subsequent years was taxable in the year of receipt.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939 and Treasury Regulations involved are printed in the Appendix, *infra.*

STATEMENT

The facts material to a determination of the issues here involved were stipulated by the parties (No. 15983, R. 65-73; No. 15984, R. 45-53) or established by allegations and admissions in the pleadings (No. 15983, R. 3-12, 57-63; No. 15984, R. 3-12, 38-45), documentary evidence (No. 15983, R. 12-57) and oral testimony (R. 113-150).

Under date of January 14, 1946, the taxpayers, each as owner of an undivided one-half interest in a certain improved commercial property located in Kalispell, Montana, referred to in the record as the Buffalo Block, and F. A. Buttrey Company, a Montana corporation, executed an instrument in writing (No. 15983, R. 4-54) entitled "Lease Agreement and Purchase Option" with respect to that particular property which gives rise to the present income tax controversy. By its terms, that instrument is exactly what it is entitled, a lease agreement and purchase option, whereby the taxpayers, as owners and parties of the first part, leased to F. A. Buttrey Company, party of the second part, for a term of ten years beginning February 1, 1946, at an annual rental of $19,000 payable in advance, the property therein described, with an option to purchase the described property, but only during the last three months of the leasehold term except on conditions not here mate-

rial, upon the giving of prior notice as therein provided and the payment of an additional amount of $75,000 in cash.

More specifically, the above "Lease Agreement and Purchase Option" provides in material part as follows (No. 15983, R. 42-44):

> Witnesseth:
>
> 1. That the said parties of the first part, for and in consideration of the rents, covenants and agreements herein mentioned and to be paid and performed by the said party of the second part, its successors and assigns, have demised, leased and let, and by these presents do demise, lease and let unto said party of the second part, its successors and assigns, the following described premises situated in the City of Kalispell, County of Flathead, State of Montana, to wit:
>
> * * * *
>
> To Have and To Hold the above described property unto the party of the second part, for and during the full term of ten (10) years beginning with the 1st day of February, 1946, and ending on the 31st day of January, 1956.
>
> 2. The party of the second part for itself, its successors and assigns, promises and agrees to pay to said first parties, their heirs, executors, administrators, or assigns, as rent for the above described property, the sum of Nineteen Thousand and No/100 Dollars ($19,000.00) per lease year, payable in cash in advance, the first year's rent to be paid at the time of the execution of this agreement, the receipt whereof is hereby acknowledged by the first parties, and that the rent for each succeeding year during the term

of this lease shall be paid by said second party on or before the first day of February of each year hereafter, and during the full period covered by this agreement.

3. It is expressly understood and agreed by and between the parties hereto that the party of the second part has viewed said premises and accepts them in their present condition, and that said second party will, at its own expense, keep said improvements in good repair during the term of this lease; and the party of the second part further covenants and agrees not to commit nor suffer any waste to be committed upon said premises, and that unless the option of purchase herein granted to the party of the second part is exercised as herein provided, said second party agrees to return said property and premises to the first parties at the end of the lease period herein provided, or the sooner termination thereof, in as good condition as it now is or may hereafter be put in by the party of the second part, reasonable wear and tear and damage by the elements alone excepted.

By paragraphs 4, 5, 6, 7, 8, 10, 11, and 14 of the "Lease Agreement and Purchase Option" (No. 15983, R. 44-48, 51-52), the lessee agreed to keep the building and improvements in good repair, maintain at least $175,000 insurance on the building, pay all state, county and city taxes assessed against the property and any improvements thereon, and fully maintain the property and furnish all fuel, light, power and water in connection with it use and occupancy; was given the right to assign or transfer the lease and to sublease, collecting such rentals as its own; was given the right to make alterations and

improvements in and upon the premises, except that for major improvements or remodeling the taxpayers' consent in writing was to be obtained, and the right to use insurance benefits to make the property tenantable if damaged by fire. The expenses of any structural improvements to the building required by order of any public authority were to be borne by the taxpayers, and the taxpayers had the right of re-entry upon the abandonment of the property by the lessee.

Paragraphs 12 and 13 of the agreement provided as follows (No. 15983, R. 48-50):

> 12. As further consideration for this agreement, the party of the second part shall have and is hereby given the right and option to purchase said leased premises and property above described for the sum of Seventy-five Thousand and No/100 Dollars ($75,000.00) at any time during the three month period beginning with November 1st, 1955 and ended with January 31st, 1956. It is mutually understood and agreed by the parties hereto that said option of purchase can only be exercised during the three month period immediately above specified except under the acceleration provisions in paragraph 4 herein, and that said option may be exercised by said second party by giving either of said first parties notice in writing of said second party's intention to exercise said option, and by depositing with the Conrad National Bank of Kalispell at Kalispell, Montana, the said sum of $75,000.00 to the credit of said first parties. It is understood and agreed, however, that in lieu of such personal service of notice of intention to exercise said option, such notice may

be sent by registered mail addressed to either of the first parties at Kalispell, Montana, and that the date of depositing such notice by registered mail at Kalispell, Montana, addressed to either of said first parties, and the depositing of such funds in said bank, shall be deemed the date of the exercise of said option.

13. It is further understood and agreed by and between the parties hereto that at the time of the execution of this agreement, the parties of the first part shall likewise execute a good and sufficient Warranty Deed conveying the property hereinabove described to said second party, free and clear of liens and encumbrances, which deed, together with a copy of this agreement, shall be deposited in escrow with said Conrad National Bank of Kalispell with instructions to said Bank that said deed be delivered to the second party only if and when said second party exercises its option of purchase hereunder in keeping with the terms and conditions herein set forth. The parties of the first part covenant and agree that they are seized and possessed of title in fee to said premises and that they will furnish an Abstract of Title covering the real estate above described, prepared and certified to by a duly licensed abstractor in and for the State of Montana, which Abstract of Title shall be delivered to Messrs. Walchli and Korn, attorneys at law, Kalispell, Montana, on or before February 1st, 1946, for the purpose of examination of said title by said attorneys, with the understanding that upon the completion of said examination, said Abstract of Title shall be returned by said attorneys to said Bank and shall thereafter be held by it in escrow with said deed and a copy of this contract, as hereinabove provided. It is under-

> stood and agreed that in the event the party of the second part shall fail to exercise said option of purchase as and within the time hereinabove specified, the said Conrad National Bank as such escrow agent shall have the right, and is hereby given the authority, to return said deed and abstract to the first parties, or either of them. It is further understood and agreed that if upon the examination of said abstract of title, it appears that the title is defective, but that such defect can be remedied, then, and in such event, the parties of the first part agree to immediately undertake and diligently prosecute the correction of any such defect at their expense. It is further agreed that any and all charges the said Conrad National Bank shall make as such escrow agent for its services hereunder shall be borne and paid for by the party of the second part.

Under date of February 1, 1946, the taxpayers and F. A. Buttrey Company executed a "Memorandum Agreement" (No. 15983, R. 54-57) reciting that "Whereas, the parties hereto have heretofore on the 14th day of January, 1946, entered into a written Lease Agreement covering" the described premises, and "Whereas, said Lease Agreement grants the above named second party the right and option to purchase all of the above described property for a stated consideration, provided such option is exercised by said second party on or between November 1, 1955, and January 31, 1956,"—

> Now Therefore, it is mutually understood and agreed that the first parties shall, in contemplation of the exercise of said option by said second party, immediately deliver to the Conrad Na-

tional Bank of Kalispell, Montana, the following papers:

1. An executed Warranty Deed coveying the above described property to the second party;

2. An abstract of title covering said property showing said first parties to be vested with a merchantable title, free and clear of encumbrances, as of the date of said Lease and Option Agreement, January 14, 1946;

the foregoing instrument to be held by said Bank in escrow and to be delivered by said Bank to the second party if and when said Option of Purchase is exercised in keeping with the terms thereof and proof of full payment by said second party under said Lease Agreement as of the time of the exercise of said option.

In the event said Option of Purchase is not exercised by the second party on or before January 31, 1956, the above mentioned papers shall be returned by said Bank to the first parties, their heirs or assigns.

The above agreements were carried out according to their terms, the Buttrey Company making the annual payments of $19,000 required thereunder to the taxpayer, and acquiring title to the property on November 5, 1955, upon exercise of its option and payment of the $75,000 as required by the agreement of January 14, 1946. (No. 15983, R. 86.)

In each of the years 1946 through 1953, both inclusive, William G. Elliot received $10,000 and Thomas W. Elliot received $9,000 as their respective shares of the $19,000 annual payments made by Buttrey Company under the above agreement. For the years 1946, 1947, 1948 and 1949 William G.

Elliot reported the $10,000 received by him each year as partnership income,[4] and for the years 1950, 1951, 1952 and 1953 he reported the amount each year as ordinary rental income. For all of the years 1946 through 1953, Thomas W. Elliot reported the $9,000 received by him in each year as ordinary rental income. (No. 15983, R. 71; No. 15984, R. 50.)

For the years 1946, 1947, 1948 and 1949 both taxpayers, and William G. Elliot for 1950 also, filed claims for refund of a portion of the income taxes paid by them for those years (No. 15983, R. 12-28, 30-33; No. 15984, R. 12-26), these refund claims all being based on the ground that the transaction evidenced by the "Lease Agreement and Purchase Option" and the Memorandum Agrement of February 1, 1946, constituted a conditional sale of the Buffalo Block property resulting in a capital gain which the taxpayers were entitled to report on the installment basis.[5] For the year 1949 both taxpayers filed a supplemental claim for refund (No. 15983, R. 29-30; No. 15984, R. 26-27), for the year 1950 William G. Elliot filed a second refund claim (No. 15983, R. 34-35), and for 1950, 1951, 1952 and 1953 Thomas W.

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[4] The evidence is not clear on this matter, and it is not of immediate importance, but apparently the Elliot brothers, George and Thomas, were partners in the business previously operated in the Buffalo Block and also in the operation of the building. (R. 113-123.)

[5] Computations attached to these refund claims (No. 15983, R. 14-17; No. 15984, R. 14-17) reflected a net gain of $226,356.73, of which one-half was taxable, with $4,270.88 being taxable to William G. Elliot for each of the years 1946 through 1955, and $3,843.80 being taxable to Thomas W. Elliot for each of those years.

Elliot (No. 15984, R. 28-35), and for 1951, 1952 and 1953 William G. Elliot (No. 15983, R. 36-41), filed refund claims, all of which latter claims demanded refund of all taxes paid by the respective taxpayers in each of those years on the ground that they had sold the property in Kalispell, Montana, to F. A. Buttrey Company in 1946 in a transaction which was completed in that year for income tax purposes, and that the payments received in subsequent years were not subject to tax in the year of receipt.

The complaints in both of these cases (No. 15983, R. 3-12; No. 15984, R. 3-12) seek recovery of only a portion of the tax paid for the years 1946 through 1953 on the ground that the transactions evidenced by the "Lease Agreement and Purchase Option" of January 14, 1946, and the Memorandum Agreement of February 1, 1946, constituted a sale of the property in question resulting in the realization of long term capital gain which they were entitled to report on the installment basis. The opinion, findings of fact and conclusions of law, and judgments in these cases No. 15983, R. 73-90; No. 15984, R. 54-55) are based on the grounds presented in the complaints, and the Director has appealed.

STATEMENT OF POINTS TO BE URGED

The basic record in each case contains a detailed statement of points to be urged by the Government. (See No. 15983, R. 101-103; No. 15984, R. 62-64.) Briefly, it is our position that the District Court erred—

1. In failing to hold, even assuming that taxpayers made a sale of their property to the Buttrey Com-

pany in 1946, that taxpayers did not elect to report the 1946 through 1953 payments to them by the Buttrey Company on the installment basis and are therefore precluded from recovering in these suits for refund on the theory that tax on the payments may now be computed on the installment basis.

2. In failing to hold, assuming that taxpayers made a sale of their property to the Buttrey Company in 1946, that, as to the years 1951 through 1953 as to taxpayer William G. Elliott and as to the years 1950 through 1953 as to taxpayer Thomas W. Elliott, there is a fatal variance between the complaints and the claims for refund on which they are based which precludes the tax refunds sought for those years.

3. In holding that the taxpayers made a sale of their property to the Buttrey Company in 1946 and that the payments received by taxpayers from the Buttrey Company in the years 1946 through 1953 were payments on the purchase price, instead of holding that the sale of the property did not occur until 1955, when the Buttrey Company exercised its option to purchase, and that the payments received in the prior years were rental income, as the taxpayers reported them on their returns.

SUMMARY OF ARGUMENT

1. The taxpayers are not entitled to recover in this case on the installment basis of reporting income for the years here involved, and the District Court erred in entering judgment for the taxpayers on that ground. The 1946 transaction which gives rise to this controversy resulted in the receipt of taxable

income by the taxpayers. For all years involved the taxpayers reported the amounts received annually as ordinary income from rents, without disclosing the nature of the 1946 transaction or making any election to have the income realized from the transaction taxed as capital gain from an installment sale of real property until refund claims for some years were filed on that basis beginning in March, 1951.

Assuming, but without admitting, that the 1946 transaction constituted a sale as alleged, rather than a lease agreement and purchase option as designated in the written instruments evidencing it, the taxpayers had the option under the law and the Regulations to report the gain from such sale either as gain from the sale of real property on the installment basis, if the transaction meets the requirements of the statute, or as a deferred payment sale of real property not on the installment basis. The taxation of such a sale as a deferred payment sale not on the installment basis, the gain being reported in the year of the sale, is in accord with the general principles of our federal income tax system that income is taxed on an annual basis and must be reported for the year in which it is received or accrues, unless under approved methods of accounting which clearly reflect the income it may be accounted for as of a different period. On the other hand, the installment method of reporting income from sales of property is a permissive method of reporting income which may be availed of by the taxpayer, if he qualifies under the statute, but which cannot be imposed upon him. It is settled that if the taxpayer makes a timely elec-

tion to report income from a sale of real property according to either method by filing his return for the year of the sale on that basis such election is binding both on the taxpayer and the Commissioner for that and subsequent years. The position of the Internal Revenue Service and the weight of authority is that the taxpayer may make a timely election to have income reported according to the installment method only by filing a timely return on that basis for the year of the sale; otherwise gain must be taxed according to general principles as income for the year of the sale. We submit that principle is applicable where, as here, the taxpayer fails to make an affirmative election in his return for the year of the alleged sale to have gain taxed on either basis, but merely reported amounts received as ordinary income without disclosing the nature of the transaction under which they were received.

2. It is settled law that the United States may be sued only with its consent and then only on such conditions and subject to such limitations as the Congress may impose. It is equally well settled that in the cases of federal taxes paid, a suit for refund thereof must be based on a timely filed refund claim, and that recovery can be had only on grounds set forth in the refund claim on which the suit is based. The courts of the United States may not grant a refund on grounds so completely at variance with grounds set forth in the refund claim as did the District Court in the instant case with respect to the years 1951 to 1953, inclusive, in the case of William G. Elliot, and the years 1950 to 1953, inclusive, in the case of Thomas W. Elliot. As to these

later years the refund claims were based on the ground that a completed sale of the taxpayer's property had occurred in 1946, no part of the gain on which was taxable in later years, while both the complaints and the judgment of the District Court were based on the ground that the agreements entered into in 1946 constituted a sale of real property in that year at a substantial gain which was taxable on the installment basis for the years in which payments were received. Even assuming a sale of the property in issue occurred in 1946, with which we do not agree, the District Court erred as to these later years in entering judgment for the taxpayers on a ground not set forth in the refund claims filed for those years.

3. Finally, recovery by taxpayers is precluded by their failure to establish that the "Lease Agreement and Purchase Option" was, instead of that, a present sale of the property in 1946. The parties' agreement was for the payment of "rent" by the Buttrey Company for a 10-year period and gave the Company, as lessee, an option to purchase the property at the end of that period for $75,000, a substantial sum. A warranty deed to the property was to be delivered to the lessee only if it exercised its option to purchase. The lessee therefore acquired no equity in the property. Under the decisions of this Court, the agreement itself is the primary evidence of the parties' intent and the other evidence in the case, while it reflects that taxpayers thought they were selling the property, does not show that they thought they were making a present sale in 1946, as distinguished from a sale at the end of the lease period.

ARGUMENT

As to all of the taxable years here involved [6] the taxpayers reported in their income tax returns, as ordinary income from rents, their proportionate shares of the annual payments received by them under the above "Lease Agreement and Purchase Option". The only ground for recovery alleged in the complaints filed herein (No. 15983, R. 3-12; No. 15984, R. 3-12) is that the transaction evidenced by that agreement and the memorandum agreement of February 1, 1946, constituted a sale of the described property in that year resulting in a long term capital gain which should be taxed on the installment basis.[7] Taxpayers of course are not entitled to recover if the payments they received from the Buttrey Company in 1946 through 1953 were rental income (as they reported the payments in their returns), instead of payments on the purchase price of property sold in 1946. But in the District Court the Government also interposed two other defenses, which were not explained too clearly but were rejected or disregarded by the District Court. (See No. 15983, R. 74-75; Finding 18, R. 87--88; Conclusion of Law 4, R. 88.) These two defenses have reference to denial of recovery even

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[6] The judgments of the District Court (No. 15983, R. 89-90; No. 15984, R. 54-55) do not include any refund for 1946 in the case of William G. Elliot because the refund claim was not timely; or any refund for 1946 or 1947 in the case of Thomas W. Elliot, presumably because the complaint was not timely filed as to those years.

[7] This also was the ground set forth in refund claims filed by William G. Elliot for 1946 through 1950, inclusive, and by Thomas W. Elliot for 1946 through 1949, inclusive.

assuming that a sale of the property occurred in 1946 (instead of 1955). The first defense—that taxpayers cannot recover on the theory of a sale reportable on the installment basis, because they did not elect in their 1946 return to report the proceeds on the installment basis—applies to all of the taxable years in suit (1946 through 1953). The other defense—a fatal variance between the claims for refund and the basis for recovery alleged in the complaints—applies to the years 1951 through 1953 as to taxpayer William G. Elliot and as to the years 1950 through 1953 as to taxpayer Thomas W. Elliot. Since the question whether a sale of the property occurred in 1946 (instead of 1955) need not in our opinion be reached, we shall discuss these latter two defenses first.

I

Taxpayers, Having Failed To Report Their Income On That Basis, May Not Now Avail Themselves Of The Benefit Of The Installment Sales Provisions Of Section 44 Of The Internal Revenue Code Of 1939

As just indicated, one of the defenses urged below by the Director was that, as to all years involved, even assuming the 1946 transaction constituted a sale of the taxpayers' property rather than a lease and purchase option, the taxpayers are not entitled to recover on the ground alleged in their complaints because they had failed to make a timely election to have the income therefrom taxed on the installment basis. In failing to so hold, we submit the District Court was in error as a matter of law.

Section 22(a) of the 1939 Code (Appendix, *infra*) defines gross income as including, among other things, all income from "sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rents, * * * or gains or profits and income derived from any source whatever". Section 42 of the 1939 Code (Appendix, *infra*), and the corresponding provisions of prior Revenue Acts on which it was based, requires that as a general rule the amount of all items of gross income shall be reported as income for the year in which received by the taxpayer, unless, under methods of accounting permitted by Section 41 of the 1939 Code, any such amounts are to be properly accounted for as of a different period. Section 41 (Appendix, *infra*) provides that the net income shall be computed on the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of the taxpayer, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.

However, statutory provision has been made for special or preferred treatment for tax purposes of specified categories of income, such as capital gains, gains from installment sales of property, etc. Generally speaking, such statutory exceptions to the general rule are intended for the benefit of the taxpayer, and not only are they strictly construed, but

the taxpayer has the burden of bringing himself squarely within the terms of such provisions. Moreover, in many instances the taxpayer is required to affirmatively indicate his election to avail himself of the benefit of such statutory provisions, usually with the filing of his return.

The statutory provision with which we are presently concerned is Section 44(b) of the Internal Revenue Code of 1939 (Appendix, *infra*), which, so far as pertinent here, provides that, in the case of a sale or other disposition of real property, if the initial payments do not exceed 30% of the selling price, "the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed" in subsection (a) of that section. Subsection (a) (Appendix, *infra*), which applies to dealers in personal property, provides that under Regulations prescribed by the Commissioner a person who regularly sells or otherwise disposes of personal property on the installment plan "may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price".[8]

Statutory recognition of the installment method of reporting income first appeared in Section 212(d) of the Revenue Act of 1926, c. 27, 44 Stat. 9, because

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[8] See Treasury Regulations 111, Sections 29.44-2, 29.44-3, and 29.44-4 (Appendix, *infra*), promulgated pursuant to Section 44 of the 1939 Code.

of doubt which had arisen as to the Commissioner's authority to permit, by regulation, such method of reporting income.[9] The installment method has always been regarded as a *permissive* method of reporting income, available to the taxpayer at his election if he is qualified under the statute to avail himself of it, but it may not be imposed upon him by the Commissioner. *Viault* v. *Commissioner*, 36 B.T.A. 430, 431-432. Compare *Louis Werner Saw Mill Co.* v. *Helvering*, 96 F. 2d 539 (C.A. D.C.), second appeal dismissed, 102 F. 2d 994 (C.A. 8th). Neither the statute nor the Regulations promulgated thereunder [10] spell out the time or manner in which a taxpayer may exercise his election to have the income from an installment sale of real property taxed in accordance with Section 44 of the 1939 Code. However, it is clear from the language of Section 44, when read in connection with the provisions of Sections 41 and 42 of the 1939 Code, and from the many decisions dealing with the subject, that a taxpayer can avail himself of the benefit of the installment method of reporting income only by making a timely and affirmative election to have the income taxed on that basis.

As illustrated by the Regulations,[11] sales of real

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[9] See S. Rep. No. 52, 69th Cong., 1st Sess., p. 19 (1926) (1939-1 Cum. Bull. (Part 2) 332, 346-347); 2 Mertens, Law of Federal Income Taxation, Sec. 15.02, p. 447.

[10] See Treasury Regulations 111, Sections 29.44-2, 29.44-3, 29.44-4.

[11] Treasury Regulations 111, Sections 29.44-2, 29.44-3, and 29.44-4.

property involving deferred payments fall into two classes, i.e., (1) sales which qualify as installment sales for purposes of the statute, and (2) deferred payment sales which do not qualify as installment sales. As to the latter class, income, of necessity, is taxed in the year of sale, computed in accordance with Section 29.44-4 of Regulations 111 (Appendix, *infra*). As to the former, Section 29.44-3 of the Regulations (Appendix, *infra*) provides that the vendor "may" return as income from such transactions in any taxable year "that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price." However, "If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such course is permissible, and the sales will be treated as deferred-payment sales not on the installment basis."

It is the position of the Internal Revenue Service, as expressed in Rev. Rul. 93, 1953-1 Cum. Bull. 82, and amplified by Rev. Rul. 56-396, 1956-2 Cum. Bull. 298, that the appropriate method of making a timely election to have income from such transactions taxed on the installment basis is to file a timely return on that basis for the year in which the transaction takes place, and the decisions generally are in accord with this position. E.g., see *Pacific National Co.*, v. *Welch*, 304 U.S. 191, and cases cited, fn. p. 195; *United States* v. *Kaplan*, 304 U.S. 195; *Commissioner* v. *Moore*, 48 F. 2d 526 (C.A. 10th), certiorari denied, 284 U.S. 620; *Walker* v. *Commissioner*, 63 F. 2d 346

(C.A. 5th), rehearing denied, 65 F. 2d 97 (C.A. 5th), certiorari denied, 290 U.S. 651; *Howbert* v. *Norris*, 72 F. 2d 753 (C.A. 10th); *Livermore* v. *Miller*, 94 F. 2d 111 (C.A. 5th), certiorari denied, 304 U.S. 582; *Louis Werner Saw Mill Co.* v. *Helvering*, 96 F. 2d 539 (C.A. D.C.), second appeal dismissed, 102 F. 2d 994 (C.A. 8th); *Marks* v. *United States*, 98 F. 2d 564 (C.A. 2d), certiorari denied, 305 U.S. 652; *Commissioner* v. *Saunders*, 131 F. 2d 571 (C.A. 5th), certiorari dismissed, 318 U.S. 796; *Jacobs* v. *Commissioner*, 224 F. 2d 412 (C.A. 9th); *Coffin* v. *United States*, 120 F. Supp. 9 (S.D. Ala.); *Frost* v. *Commissioner*, 37 B.T.A. 190; *Thrift* v. *Commissioner*, 15 T.C. 366; *Cedar Valley Distillery, Inc.* v. *Commissioner*, 16 T.C. 870; *Vischia* v. *Commissioner*, 26 T.C. 1027, and numerous others involving analogous situations.

The above decisions, especially *Pacific National Co.* v. *Welch*, *supra*, and *United States* v. *Kaplan*, *supra*, make it clear that the filing of a timely return for the year in which the sale occurs, in which the income from the sale is reported either as an installment sale if it otherwise qualifies as such under the statute, or as a deferred payment sale not on the installment basis, constitutes an election by the taxpayer to have the income taxed on that basis which is binding both on the taxpayer and the Commissioner. More than that, they support the position of the Internal Revenue Service [12] that if the taxpayer fails to elect the installment method of reporting income in a timely return for the year of sale he has forfeited his right

[12] Rev. Rul. 56-396, 1956-2 Cum Bull. 298.

of election. For instance, in *Briarly* v. *Commissioner*, 29 B.T.A. 256, cited with approval in *Pacific National Co.* v. *Welch*, *supra*, p. 195, fn., where returns were not filed by the taxpayers for the year of sale but were prepared by the Collector at a later date, gain from the sale of property being treated as gain from a deferred payment sale not on the installment basis, it was held that the taxpayers, while they may have elected to return the gain on the installment basis, had forfeited their right to do so by failing to file a timely return on that basis. And where a return is filed for the year of sale but income from the sale is not reported on either basis, it is generally held that the taxpayer has lost the right to have such income taxed on the installment basis. E.g., *Howbert* v. *Norris*, *supra*; *Livermore* v. *Miller*, *supra*; *Louis Werner Saw Mill Co.* v. *Helvering*, *supra*; *Frost* v. *Commissioner*, *supra*; *Cedar Valley Distillery, Inc.* v. *Commissioner*, *supra*.

The appropriateness of requiring the taxpayer to make an affirmative election in a timely return for the year of sale to have income taxed on the installment basis, instead of having his tax computed according to general principles, is emphasized by the general requirements of Sections 41 and 42 of the 1939 Code, to which Section 44 is an exception, and the underlying principle of our tax system that income is to be accounted for on an annual basis. Aside from the equitable considerations involved,[13] it is most

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[13] Compare *Commissioner* v. *Moore*, *supra*, and *Marks* v. *United States*, 18 F. Supp. 911, 91B (S.D. N.Y.), affirmed, 98 F. 2d 564 (C.A. 2d), certiorari denied, 305 U.S. 652, both cited with approval in *Pacific National Co.* v. *Welch*, *supra*,

essential, both from an administrative standpoint and for the protection of the revenue, that the taxpayer make an affirmative election in his original return for the year of the sale or else be taxed in accordance with the principles governing taxation of income generally.[14]

As the Supreme Court said in *Pacific National Co.* v. *Welch*, *supra* (pp. 194-195):

> The parties agreed that, if allowed to change to the installment method, petitioner would be entitled to a refund in some amount. But that fact has no tendency to discredit the deferred payment method as inapplicable. The amount of the tax for the year in question is only one of

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fn. p. 195; also, *Walker* v. *Commissioner*, 63 F. 2d 346 (C.A. 5th), rehearing denied, 65 F. 2d 97 (C.A. 5th), certiorari denied, 290 U.S. 651; *Howbert* v. *Norris*, 72 F. 2d 753 (C.A. 10th); *Livermore* v. *Miller*, 94 F. 2d 111 (C.A. 5th), certiorari denied, 304 U.S. 582; *Louis Werner Saw Mill Co.* v. *Helvering*, 96 F. 2d 539 (C.A.D.C.), second appeal dismissed, 102 F. 2d 994 (C.A. 8th); *Saunders* v. *United States*, 101 F. 2d 133 (C.A. 5th).

[14] The necessity for such election was recognized by Congress in enacting Section 705 of the Revenue Act of 1928, c. 852, 45 Stat. 791, relating to retroactive application of the installment method where a taxpayer had "by an *original return* * * * changed the method of reporting his net income * * * to the installment basis * * *." [Italics supplied.] As the House Bill (H.R.1, 70th Cong., 1st Sess.) passed the Senate, Section 705(a) read: "If any taxpayer by a return or an amended return * * *", but was amended in conference to read as above. See H. Conference Rep. No. 1882, 70th Cong., 1st Sess., p. 7 (1928) (1939-1 Cum Bull. (Part 2) 444, 445); also, H. Rep. No. 2, 70th Cong., 1st Sess., pp. 14-15 (1927) (1939-1 Cum. Bull. (Part 2) 384, 393-394); S. Rep. No. 960, 70th Cong., 1st Sess., pp. 22-24 (1928) (1939-1 Cum Bull. (Part 2) 409, 424-426).

> many considerations that may be taken into account by the taxpayer when deciding which method to employ. The one that will produce a higher tax may be preferable because of probable effect on amount of taxes in later years. In case of overstatement and overpayment, the taxpayer may obtain refund calculated according to the method on which the return was made. Change from one method to the other, as petitioner seeks, would require recomputation and readjustment of tax liability for subsequent years and impose burdensome uncertainties upon the administration of the revenue laws. It would operate to enlarge the statutory period for filing returns (§ 53 (a)) to include the period allowed for recovering overpayments (§ 322 (b)). There is nothing to suggest that Congress intended to permit a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed and settled according to the other method. By reporting income from the sales in question according to the deferred payment method, petitioner made an election that is binding upon it and the commissioner.

See, also, the decision of this Court in *Jacobs* v. *Commissioner*, 224 F. 2d 412.

One aspect of the administrative difficulties which may be encountered from failure to require a timely and affirmative election by the taxpayer to report income from a sale of real property on the installment basis, when that method is applicable, and also a sound legal basis for reversing the decision of the District Court herein, is demonstrated by the facts of this case. Here, the taxpayers filed their income tax returns for 1946, the year of the alleged sale,

and for all succeeding years involved, without making any disclosure concerning the 1946 transaction in any of their returns. Apparently the first disclosure made to the Commissioner of anything relating to this transaction was made with the filing of their first refund claims (for 1946) in March, 1951, at a time when the Commissioner was barred by the statute of limitations [15] from assessing any additional tax for that year had he been so inclined. After filing refund claims for 1946 the taxpayers continued to file returns reporting payments received under the 1946 agreement as rental income, and continued to file refund claims on the installment basis for each year prior to expiration of the statute of limitations for such year until William G. Elliot had filed refund claims on that basis for the years 1946 through 1950 and Thomas W. Elliot had filed claims on that basis for all years 1946 through 1949. Thereafter, apparently abandoning the installment basis for seeking refunds, both taxpayers filed refund claims, supplemental or second claims, for the full amount of taxes paid for the years 1949 through 1953—earlier years then being barred by the statute of limitations—on the ground that all gain from the alleged sale was taxable in 1946. It was not until the complaints were filed in the court below that the taxpayers took a definite position that income from the alleged 1946 sale of property was taxable on the installment basis in the years the payments under the "Lease Agreement and Purchase Option" of January 14, 1946,

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[15] Section 275(a) of the Internal Revenue Code of 1939.

were received. Furthermore, under the concumstances disclosed by the record, it is only reasonable to assume that the Buttrey Company, rather than treating the payments involved as annual payments on the purchase price of property, was claiming and being allowed the amount of these payments as deductible business expenses (rent) on its income tax returns.

In the situation disclosed by the record in these cases we submit that, assuming a sale of the property involved in 1946, the taxpayers have failed to establish any basis for recovery for any year covered by their complaints on the ground that the gain realized on that sale should be taxed on the installment basis in the years the payments in issue were received, and the District Court erred in failing to so hold.

Taxpayers no doubt will rely upon the decision in *Scales* v. *Commissioner*, 211 F. 2d 133, a case involving a somewhat analogous situation so far as this election issue is concerned, in which the Court of Appeals for the Sixth Circuit reversed the decision of the Tax Court, reported at 18 T.C. 1263, and held that the taxpayer was entitled in a deficiency proceeding before the Tax Court to have his income for the year of the sale taxed on the installment basis although he had reported it as rental income. Without going into too much detail, the taxpayer in that case sold a dairy farm, including improvements and personal property thereon, in 1943, the transaction being evidenced by several written instruments, including an agreement couched in terms of a lease-sale undertaking intended for the benefit of the seller in case of default by the purchaser, and two interest

bearing promissory notes, one for the price of the land and improvements and one for the price of the personal property, payable in monthly installments over a period of five years, with no initial down payment. In his 1943 return the taxpayer reported as rental income the amount of the monthly payments received in that year without disclosing any information regarding the agreement under which the payments were received. In asserting a deficiency for that year the Commissioner, among other things, held that the transaction constituted a sale in 1943 and treated as a capital gain for that year the profit realized on the transaction. The taxpayers then raised the issue in the Tax Court whether such gain was taxable on the installment basis. The Tax Court rejected this contention, primarily on the ground that the taxpayer had not made a timely election to have its income from the sale taxed on the installment basis. The Court of Appeals, without any serious explanation of its reason for doing so, held on the authority of its earlier decision in *United States* v. *Eversman*, 133 F. 2d 261, that the taxpayer was entitled to have his gain for the year of sale computed on the installment basis. A most superficial examination of the facts in the *Eversman* case, *supra*, will show that it is clearly distinguishable from the instant case. Moreover, as this Court felt in *Jacobs* v. *Commissioner*, 224 F. 2d 412, 414, if the case of *Scales* v. *Commissioner*, *supra*, is not distinguishable, we cannot agree with it. It should be noted, however, that the *Scales* case dealt only with the year of sale, rather than also with a long period of time following the

year of sale in which the taxpayers continued to report the rental payments as such; that it was a proceeding before the Tax Court for redetermination of deficiency for the year of sale rather than a suit for refund where the burden of proof is more exacting; and that this case, at least, it not one merely of "failure of the taxpayer 'to adopt fruitless ritualistic measures'" (211 F. 2d 134), as clearly shown by the amount of the judgments entered by the District Court. Moreover, while the court may have been technically correct in its statement in the *Scales* case, *supra*, that the taxpayer reported as rent "the same amount as would have been reported as payments from an installment sale" (p. 134), the statement implies a misunderstanding because the land and improvements sold there had a substantial cost basis which would reduce the amount of gain reportable—most of which was a capital gain rather than ordinary income. Moreover, the decision in the *Scales* case fails to take into consideration the necessity for the taxpayer to have his profit from an installment sale taxed under Section 44(b) if it is not to be taxed in accordance with Sections 41 and 42 of the 1939 Code.

We submit that on the basis of the foregoing authorities an affirmative and timely election to that effect is necessary if a taxpayer is to have income from the sale of real property taxed on the installment basis, and that in the instant case no such timely election was made. Contrary to the District Court's finding and holding (No. 15983, R. 88), there *is* a "procedural or substantive rule of law which

prohibits the making of these refunds". Accordingly, the District Court erred in entering judgment for the taxpayers on the installment basis and its judgment should be reversed.

II

The District Court Erred In Any Event In Entering Judgment For The Taxpayers On The Basis Of Installment Taxation Of Income For Those Years In Which Refunds Were Claimed On The Basis That Income From The 1946 Transaction Had Been Erroneously Reported For The Later Years

In addition to the contention, discussed above, that the taxpayers may not recover for any of the years involved in these suits because they did not make a timely election to have their alleged capital gain taxed on the installment basis, the Government further contended before the iDstrict Court (No. 15983, R. 74-75) that as to the years 1951, 1952 and 1953 in the case of William G. Elliot and as to the years 1950, 1951, 1952 and 1953 in the case of Thomas W. Elliot, even assuming that a sale of the property in question occurred in 1946 as claimed, the taxpayers may not recover in any event because their complaints were not based on grounds set forth in their refund claims for those years.

As pointed out above, the complaints as to all years involved in these suits were based on the ground that the 1946 transaction in issue constituted an installment sale of the taxpayers' real property in that year, the income from which was taxable on the installment basis in the years in which payments were received. Actually, this statement was of neces-

sity based on the refund claims first filed by the taxpayers,[16] the facts alleged in their complaints (No. 15983, R. 3-12; No. 15984, R. 3-12) and the amount of recovery sought by the prayer of the respective complaints. The refund claims clearly were based upon the ground that the property in issue allegedly was sold for $265,000, payable $19,000 a year plus a final payment of $75,000, resulting in a capital gain of $226,356.73 which was reportable on the installment basis as payments were received, and the prayer of the complaints as to the years covered by refund claims for these earlier years is for the amounts, with interest, set forth in the refund claims filed for those years, although as to all years the complaints merely allege that as to the 1946 transaction "The transfer set forth in paragraph (22) above resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939". (No. 15983, R. 11; No. 15984, R. 11.) For the later years here under discussion, the refund claims filed by the taxpayers (No. 15983, R. 36-41; No. 15984, R. 28-35) were for the full amount of the tax paid for such year, and were based on the alleged ground that the taxpayers had erroneously reported their respective shares of the yearly payment under the 1946 agreement as rental income and paid the tax thereon at ordinary income tax rates whereas, under the law, "a completed sale occurred in 1946 resulting in a long term capital gain" (No. 15983, R. 37, 39, 41; No.

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[16] For the years 1946 through 1950 by William G. Elliot (No. 15983, R. 12-28, 32-33) and for the years 1946 through 1949 by Thomas W. Elliot (No. 15984, R. 12-26).

15984, R. 29, 31, 33, 35).[17] However, the prayers of the complaints were for a lesser amount than the full tax paid for each year, apparently computed on the basis of taxing a proportionate amount of the payment received each year as long term capital gain. Moreover, this variance is emphasized by the so-called supplemental claim filed by each taxpayer for 1949 setting out the new ground for refund in which appears the statement that (No. 15983, R. 29-30; No. 15984, R. 27)—

> The original refund claim previously filed claimed capital gain treatment on payments received from certain property, using the installment basis method of computing gain on the transaction.
>
> This claim is filed to claim the right to exclude all payment received during 1949 on this transaction on the grounds that a sale occurred in 1946 and that payments received in subsequent years are not income.

That an action will not lie for a refund of taxes where the complaint is based on a grounds entirely different from the grounds set forth in the refund claim on which it is based is so well settled that discussion or citation of authority to demonstrate the District Court's error in entering judgment with respect to the later years enumerated above seems superfluous. Reference to this Court's decision in

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[17] In fact, it is not clear that the complaints can reasonably be said to be based on the same grounds as the earlier refund claims because they contain no allegation that the gain from the 1946 sale is taxable on the installment basis—or at any other time or in any other manner, for that matter.

Daley v. *United States*, 243 F. 2d 466, certiorari denied, 355 U.S. 832, and the decision of the Court of Appeals for the Second Circuit in *Marks* v. *United States*, 98 F. 2d 564, certiorari denied, 305 U.S. 652, would seem to be sufficient. In fact, the problem in the instant cases so far as this issue is concerned, even assuming a sale occurred in 1946, seems to be indistinguishable from that involved in the *Marks* case, *supra*. See, also, *B. F. Goodrich Co.* v. *United States*, 135 F. 2d 456, 460-461 (C.A. 9th), affirmed on another ground, 321 U.S. 126; *French* v. *Smyth*, 110 F. Supp. 195 (N.D. Calif.), affirmed by this Court without opinion *sub nom.*, *French* v. *Berliner*, 218 F. 2d 351, and cases cited; *Carmack* v. *Scofield*, 201 F. 2d 360 (C.A. 5th), certiorari denied, 340 U.S. 875. Compare *Real Estate Title Co.* v. *United States*, 309 U.S. 13, 16-17; *Rogan* v. *Ferry*, 154 F. 2d 974 (C.A. 9th); *Vica Co.* v. *Commissioner*, 159 F. 2d 148 (C.A. 9th). In *Rogan* v. *Ferry*, *supra*, this Court most appropriately observed that (p. 976)—

> It is of course the law that a suit for refund of taxes must be based on a claim previously filed with the Commissioner, and that the claim must set forth in detail each ground on which a refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof.

As this Court is fully advised, it long has been settled that the Government can be sued only with its consent and only upon such conditions and subject to such limitations as the Congress may impose. It is equally well settled that the courts of the United States can entertain an action for refund of taxes paid, whether the action is brought nominally against

the Collector or directly against the United States, only when the action is based upon specific grounds set forth in a timely claim for refund. In addition to the cases cited above, see *United States* v. *Felt & Tarrant Co.*, 284 U.S. 269; *United States* v. *Memphis Cotton Oil Co.*, 288 U.S. 62; *United States* v. *Henry Prentiss & Co.*, 288 U.S. 73; *United States* v. *Factors & Finance Co.*, 288 U.S. 89; *Bemis Bro. Bag Co.* v. *United States*, 289 U.S. 28; *United States* v. *Andrews*, 302 U.S. 517; *United States* v. *Garbutt Oil Co.*, 302 U.S. 528; *Angelus Milling Co.* v. *Commissioner*, 325 U.S. 293. The decisions in *United States* v. *Andrews*, *supra*, and *United States* v. *Garbutt Oil*, *supra*, make it eminently clear that the taxpayer may not, as these taxpayers did in the court below, recover in a suit based upon a ground so unrelated to the ground set forth in the refund claim on which it was based. Clearly, for the years 1951 through 1953 as to William G. Elliot and the years 1950 through 1953 as to Thomas W. Elliot, the District Court was in error, as a matter of law, in finding (No. 15983, R. 87-88) that "there is no fatal variance between the refund claims * * * and the complaints filed herein and that there is no procedural or substantive rule of law which prohibits the making of these refunds."

III

No Sale Of The Property To Buttrey Company Occurred In 1946; The Amounts Received By Taxpayers During The Years 1946 Through 1953 Were Rental Income

The District Court found as a fact that "it has been conclusively established that" taxpayers "did, in

fact, make a sale of their property to Buttrey Co. [in 1946] * * * and that the yearly rentals, so called, were installment payments on the purchase price * * *." (No. 15983, R. 86.) But the question whether there was a sale in 1946, or a lease until the option to purchase was exercised, as we contend, is *not* one of pure fact; it is at least a mixed question of law and fact, as this Court has plainly indicated. *Oesterreich* v. *Commissioner*, 226 F. 2d 798 (C.A. 9th); *Commissioner* v. *Wilshire Holding Corp.*, 244 F. 2d 904 (C.A. 9th), certiorari denied, 355 U.S. 815, rehearing denied, 355 U.S. 879; *Haggard* v. *Commissioner*, 241 F. 2d 288 (C.A. 9th); *Benton* v. *Commissioner*, 197 F. 2d 745 (C.A. 5th); see also, *Breece Veneer & Panel Co.* v. *Commissioner*, 232 F. 2d 319 (C.A. 7th). As the Court stated in its *Oesterreich* opinion, *supra*, p. 803, "The intention of the parties, as expressed in the instrument, was cardinal * * *. No question of fact was involved".

Here, looking to the instrument involved, as well as the other evidence bearing on the parties' intent, the instrument (Ex. K, No. 15983, R. 41-52) was exactly what it purported to be—a "Lease Agreement and Purchase Option". This case is not like *Oesterreich*, where the lessee was to acquire title to the property at the end of the lease term for a nominal amount ($10), there was no question that the purchase option would be exercised, and the lessee acquired an equity in the property. Here, where the instrument provided for a 10-year period for payment of "rent" (No. 15983, R. 43), the option was to purchase the property at a substantial price, $75,000, and

a warranty deed to the property, held in escrow (No. 15983, R. 54-56), was to be delivered to the lessee "only if and when said second party exercises its option of purchase hereunder in keeping with the terms and conditions herein set forth" (No. 15983, R. 49). The Buttrey Company therefore acquired no equity in the property until the purchase option was exercised. *Helvering* v. *San Joaquin Co.*, 297 U.S. 496, 498, 500. Moreover, the "rent", $19,000 "per lease year" (No. 15983, R. 43), could not have been substantially more than the rental value of the property, except for the lessee's obligation to pay maintenance expenses (perhaps about $9,500 a year, see No. 15983, R. 83-84), for in the 1945 negotiations for straight rental with*out* a purchase option, the lessee had agreed to pay what amounted to a total rental of $1,200 a month, or $14,400 a year, for only the first floor of the building (R. 123), as the District Court found (see No. 15983, R. 84), and, as the District Court further found (*id.*, R. 83), taxpayers "also collected some rentals from the office space on the second story".

While the District Court found as a fact that "it was so understood by both parties" that a sale was made in 1946 (No. 15983, R. 86), that finding is not supported by either the "Lease Agreement and Purchase Option" or by the other evidence. Some significance, so far as the parties' intent is concerned, must be attached to the fact that the parties called the transaction a "Lease Agreement and Purchase Option" and made provision for the payment of "rent" by the Buttrey Company, although, as the Court held in the *Oesterreich* case, the nomenclature is not con-

trolling. It is also significant that both taxpayers reported the payments by the Buttrey Company for the taxable years as rental income. Taxpayer Thomas W. Elliot apparently thought he was selling the property (see R. 124, 134, 142-143) and, indeed, his nephew (the son of taxpayer William G. Elliot, R. 139-140), had advised him to sell (R. 142). But there is no evidence that Thomas W. Elliot thought he was selling the property as of 1946, instead of at the end of the lease period. He testified that he read the lease agreement and purchase option before signing it (R. 125), made no suggestion or request for any change in the instrument (R. 126), and did not concern himself with its legal effect (R. 127). He also testified that the yearly payments by the Buttrey Company were reported as rental income in returns made out for taxpayers by a bookkeeper (R. 129-131) to whom he turned over what he called "the rental receipts and records" (R. 130). Apparently it was not until later, when his nephew advised him that the Buttrey Company had taken advantage of them taxwise (see R. 144), that he gave any thought to treating the lease agreement and purchase option as effecting a sale *in 1946*.

In point of fact and law, with the "Lease Agreement and Purchase Option" the "cardinal" criteria (*Oesterreich* v. *Commissioner*, *supra*, p. 803), there was no present sale of the property in 1946. Cf. *Benton* v. *Commissioner*, *supra*. The payments received from the Buttrey Company by taxpayers during the years 1946 through 1953 were rental income, as they reported it in their returns.

It should be noted that in these suits for refund taxpayers had the burden of proof. *Lewis* v. *Reynolds*, 284 U.S. 281. They have failed to sustain their burden of proving that their "Lease Agreement and Purchase Option" was, instead of that, a present sale of the property in 1946.

CONCLUSION

For the reasons stated, the judgment of the District Court should be reversed.

Respectfully submitted,

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AUGUST, 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in Personal Property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of Realty and Casual Sales of Personality.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regu-

lations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

* * * *

(26 U.S.C. 1952 ed., Sec. 44.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.44-2. *Sale of Real Property Involving Deferred Payments.*—Under section 44 deferred-payment sales of real property include (a) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (b) sales in which there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments. Such sales, either under (a) or (b), fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do no exceed 30 percent of the selling price;

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other

than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 30 percent of the selling price.

* * * *

Sec. 29.44-3. *Sale of Real Property on Installment Plan.*—In transactions included in class (1) in section 29.44-2 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price.

* * * *

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

Sec. 29.44-4. *Deferred-Payment Sale of Real Property Not on Installment Plan.*—In transactions included in class (2) in section 29.44-2, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.

* * * *

If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are dis-

posed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

Sections 39.44-2, 39.44-3 and 39.44-4 of Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, applicable to the taxable years 1952 and 1953, are substantially identical with the sections set out above.

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Nos. 15983 and 15984
Civil

United States Court of Appeals

For the Ninth Circuit

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Appellant

v.

WILLIAM G. ELLIOT,

Appellee

THOMAS M. ROBINSON,

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EVELYN W. ELLIOT,

Appellees

Appeal from the United States District Court
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Appellees' Brief

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United States Court of Appeals

For the Ninth Circuit

THOMAS M. ROBINSON,

Appellant

v.

WILLIAM G. ELLIOT,

Appellee

THOMAS M. ROBINSON,

Appellant

v.

THOMAS W. ELLIOT AND EVELYN W. ELLIOT,

Appellees

Appeal from the United States District Court for the District of Montana

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Appellees' Brief

STATEMENT OF THE CASE

This appeal presents one question on the merits. The appellant has also raised two procedural questions.

The question on the merits concerns whether the so-called "Lease Agreement and Purchase Option" as sup-

plemented by a "Memorandum Agreement" constitutes a sales agreement of real property resulting in the payments made thereunder being subject to capital gain treatment.

Concerning the procedural questions, one involves Section 44 of the 1939 Internal Revenue Code; the other involves an alleged "fatal variance" between some of the refund claims filed and the allegation contained in the complaints.

We respectfully submit that under the facts and law involved in this case, that the agreement in question constituted a sales agreement rather than a true lease, and that therefore the appellees are entitled to capital gain treatment on the payments received by them and are entitled to the refunds as set forth in the judgments rendered by the Montana District Court and it is further respectfully submitted that the procedural questions raised by the appellant must be decided in favor of the appellees.

We respectfully submit that there was no error committed by the trial court and that the judgments should be affirmed. In this connection it is noted that Rule 52 (a) of the Rules of Civil Procedure provides that the findings of fact of a district court in all actions tried without a jury shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.

STATUTES INVOLVED

1939 Internal Revenue Code:

Sec. 111. Determination of amounts of, and Recognition of Gain or Loss.

(a) Computation of Gain or Loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Sec. 117. Capital Gains and Losses.

* * * * * * * * * * *

(b) Deduction From Gross Income. — In the case of a taxpayer other than a corporation, if for any taxable year the net long-term capital gain exceeds the net short-term capital loss, 50 per centum of the amount of such excess shall be a deduction from gross income.

* * * * * *

Sec. 23. Deductions From Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or Business Expenses.—

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a con-

dition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

INTRODUCTION

The statement of facts contained in appellant's brief is incomplete and also contain inaccuracies. Accordingly, we shall review the evidence and the trial court's Findings of Fact somewhat in detail.

The statement of facts relating to the issue on the merits will be set forth and followed by appellees' argument on the merits and thereafter a statement of facts relating to the two procedural questions will be made and followed by appellees' argument thereon.

The evidence in these cases consisted of:

1. The testimony of three witnesses all of whom were witnesses for the appellees. No witnesses testified for the appellant and the appellant did not cross-examine the witnesses for the appellees. (R. 113-150).

2. Stipulations of Facts which were agreed upon and admitted as evidence in both cases (No. 15983, R. 65-73; No. 15984, R. 45-53).

3. A stipulation of Documentary Evidence was agreed upon and admitted as evidence in both cases (No. 15983, R. 65.)

4. Plaintiff's Exhibit No. 1 was stipulated into evidence in both cases. (R. 112).

STATEMENT OF FACTS RELATING TO THE ISSUE ON THE MERITS

Mr. Thomas Elliot, prior to the year 1946, was an officer and the manager and operator of the Flathead Commercial Company, a corporation, at Kalispell, Montana. He ran the business of this company which was engaged in the sale of general merchandise and in the operation of a department store. It had been in business since the 1920's. (No. 15983, R. 81; R. 114, 115).

During 1945, Mr. Thomas Elliot was approached by the F. A. Buttrey Company (hereinafter called Buttrey Co.), a well-known Montana corporation which operates a number of retail department stores. Said company desired to purchase the business of the Flathead Commercial Company. Buttrey Co. had previously discussed such a purchase but serious negotiations were not entered into until July or August of 1945. Late in 1945, Mr. Thomas Elliot decided, principally due to reasons of his health, to sell his store business, that is, the business of the Flathead Commercial Company. Negotiations were carried on in Billings in December of 1945 with representatives of Buttrey Co. and Mr. Thomas Elliot's brother, Mr. William Elliot, and his nephew, Mr. Howard Elliot, were also present. During these negotiations, a final agreement was made for the sale of the goods and business of the Flathead Commercial Company to Buttrey Co. Subsequently, Mr. Thomas Elliot, as the President of the Flathead Commercial Company, executed an affidavit and statement as required by the Montana

Bulk Sales Law (No. 15983, R. 82; No. 15984, R. 36; R. 116, 120, 121, 123).

The business of the Flathead Commercial Company was conducted in a building known as the Buffalo Block in Kalispell, Montana. (No. 15983, R. 82; R. 115).

The Buffalo Block consisted of two stories and a basement and it contained store fronts, brick walls and the usual internal divisions supporting the walls. The Buffalo Block had a 125-foot frontage on Main Street in Kalispell of which the Flathead Commercial Company occupied a 75-foot frontage thereof on the first floor and in the basement. The remaining 50-foot frontage on the first floor and basement was occupied by Safeway Stores in 1945. The second floor consisted of office spaces which were rented to various tenants. Vacancies existed from time to time. Safeway Stores held a lease on the space occupied by them which lease expired in 1947. (No. 15983, R. 82, 83; R. 114-116, 123).

The Buffalo Block was owned by Mr. Thomas Elliot and his brother, Mr. William Elliot, each owning an undivided one-half interest. They had purchased this property in 1923. (No. 15983, R. 83; R. 115).

As shown by Plaintiffs' Exhibit #1, the total gross income from the various tenants of the Buffalo Block (as indicated in the table on the bottom of the exhibit) averaged approximately $16,500, a year for the ten-year period commencing in 1936 and terminating at the end of 1945, that is, just prior to the execution of the so-called "Lease Agreement and Purchase Option" on January

14, 1946. The expense of operating the Buffalo Block averaged approximately $9,500 a year and, as shown on the table at the top of the exhibit, such expense consisted of taxes, heat, office expense, repair, wages, light, water insurance, and general expense and that, in addition, depreciation in the approximate amount of $2,000 was inincurred. The average annual net income was, therefore, approximately $5,000. (No. 15983, R. 79, 83, 84; R. 112).

During the negotiations with Buttrey Co. concerning the sale of the Flathead Commercial Company, there was no discussion regarding the purchase of the Buffalo Block but it was agreed at that time that Buttrey Co. would be allowed to take over the space then occupied by the Flathead Commercial Company. Buttrey Co. offered to lease such space at $775 a month for 15 years provided they were given the option to lease the space then occupied by Safeway Stores at $425.35 a month at the expiration of Safeways Store's lease in 1947 or sooner should Safeway Stores vacate the premises. These negotiations took place in Billings, Montana during December of 1945, but no agreement was made at that time. (No. 15983, R. 84; R. 122-124).

Subsequent to January 1, 1946, the appellees were again approached regarding the disposition of the Buffalo Block and these negotiations took place in Kalispell, Montana. On January 14, 1946, in the law office of the attorneys representing Buttrey Co., the so-called "Lease Agreement and Purchase Option" was executed. On

February 1, 1946, the supplemental "Memorandum Agreement" was executed. The said agreements were prepared by the attorneys for Buttrey Co. The appellees were not represented by any lawyer and they paid no legal fees in this matter. The Elliot brothers were unfamiliar with tax matters, and also with technical sales agreements and they relied upon Buttrey Co.'s attorneys. They were simply selling their property and all of it. (No. 15983, R. 78, 84, 85; R. 124-127).

The above-referred to agreements specified that an abstract of title, together with a title opinion and a warranty deed, wherein the appellees conveyed the property to Buttrey Co., were to be placed in escrow in the Conrad National Bank at Kalispell, and this was done. The agreements stated that the abstract of title, title opinion, and the warranty deed were to be delivered to Buttrey Co. by said bank provided that full payment was made therefor. (No. 15983, R. 85; R. 127, 128).

After the execution of the agreements, the appellees vacated the premises and subsequent to that time they did not pay any expenses in connection with the Buffalo Block, including real estate taxes or repairs, nor did they collect any rentals from any of the tenants of the building. The appellees completely terminated their relation with the management and control of the building, except to make sure that the insurance was kept up. In Paragraph 4 of the agreement, it is provided that fire insurance in the amount of at least $175,000 be maintained by Buttrey Co. and that Buttrey Co. later increased the

amount of insurance on the building, without being requested to do so by the appellees, to the sum of $250,000. (No. 15983 R. 85, 86; R. 128, 137-139).

The fair market value of the property known as the Buffalo Block on January 14, 1946 was approximately $200,000. (No. 15983, R. 86; R. 138, 139, 145-150).

It was intended that Buttrey Co. would make the final $75,000 payment referred to in the agreement. A provision of the "Memorandum Agreement" provided that the parties contemplated the making of this payment and it was, in fact, made on November 5, 1955. The agreements were completely performed on that date, that is, the appellees had received all of the payments provided for therein and Buttrey Co. received the deed, abstract, and title opinion from the escrowee. The terms of the agreement had been performed precisely as written therein and were fully consummated and the agreements constituted a sales agreement and were intended as such by the parties. (No. 15983, R. 77-79, 86; R. 138, 135, 127).

In a further Finding of Fact (No. 15983, R. 86), the District Court found that it has been conclusively established that the Elliot brothers did, in fact, make a sale of their property to Buttrey Co. and that it was so understood by both parties, and that the yearly rentals, so called, were installment payments on the purchase price, and that such is the construction to be placed upon the agreements in question, and that they should be treated accordingly for Federal income tax purposes.

ARGUMENT

The District Court correctly held that the agreement in question constituted a sales agreement rather than a true lease agreement.

1. *GENERAL DISCUSSION.*

Mr. Thomas Elliot, who had owned and operated the Flathead Commercial Company for a number of years, decided to sell the assets of that business and to retire. This decision was made in December of 1945 during which time negotiations were held in Billings, Montana, with Buttrey Co. As the owner and President and manager of such company, he consummated the sale of the assets and business of the Flathead Commercial Company. In conjunction with this sale, Mr. Elliot later executed an affidavit and statement required by Section 8607 of the 1935 Revised Codes of Montana. Said affidavit was executed and acknowledged on January 31, 1946 (No. 15984, R. 36, 37).

During the negotiations held in Billings, Montana, during December of 1945, it was further agreed that Buttrey Co. would have the same space formerly occupied by the Flathead Commercial Company. Buttrey Co. offered to lease the space occupied by the Flathead Commercial Company for $775.00 a month for a period of 15 years with the option to lease the space occupied by Safeway Stores for $425.35 a month at the expiration of their lease in 1947 or sooner should Safeway Stores vacate the premises. Therefore, under this offer, Buttrey Co. agreed to lease the entire first floor and basement

space thereunder for a total of $1,200.35 a month for a 15-year period. That is, they agreed to rent the principal part of the Buffalo Block for that sum. This offer did not contain any provision regarding an option to purchase the property and if this offer had been accepted, the Elliot brothers would have continued to be true landlords and would have had to pay the taxes, insurance, repairs, and other necessary costs ordinarily incurred by the owners of business real estate. They would have continued to rent the space on the second floor of the building. At the end of the lease term, the Elliots would still have owned this property. The total gross yearly rental which would have been payable by Buttrey Co. if this offer had been accepted would have been $14,404.20 ($1,200.35 a month for 12 months). However, this offer was not accepted.

Subsequently, the appellees met with representatives of Buttrey Co. in Kalispell, Montana, in the office of Buttrey Co.'s attorneys and, on January 14, 1946, the so called "Lease Agreement and Purchase Option" was executed by the appellees and by Buttrey Co. On February 1, 1946, the "Memorandum Agreement" was executed by the same parties. The agreements were prepared by the attorneys for Buttrey Co. and the appellees were not represented by a lawyer and they incurred no legal fees in this matter.

In contrast with their prior offer, Buttrey Co., under the so-called "Lease Agreement and Purchase Option," agreed to pay to the appellees $19,000 a year and, in ad-

dition, Buttrey Co. agreed to pay all of the costs and expenses normally incurred by the owner of property. Hence, under this offer, Buttrey Co. would pay $19,000 to the appellees and maintenance expense of perhaps $9,500 or a total of $28,500. This sum would be offset to a small extent by the rentals from the office space on the second story since the appellees did collect some rentals therefrom when they were not vacant. Of course, their principal rental income had come from the store rentals on the main floor of the building. The total gross rentals per year were some $16,500. The logical reason for making these higher payments can only be explained on the basis that Buttrey Co. knew it was making payments on the purchase price of the property rather than true rental payments for the use of the property.

Prior to entering into this so-called "Lease Agreement and Purchase Option," the appellees received an average of some $16,500 a year in gross rentals and incurred average yearly expenses of $9,500 in addition to approximately $2,000 of depreciation, leaving a net yearly income of approximately $5,000; after the agreement was entered into the appellees received $19,000 a year and they did not incur any expense!

What is the reason for this increase of some $14,000 a year in the appellees' "rental" income?

Certainly the above comparison regarding Buttrey Co.'s prior offer to lease the premises and the comparison between the prior net rental income of some $5,000 earned by the appellees as compared with the net "rental"

income of $19,000 after the agreement was executed are additional factors in establishing that the $19,000 yearly "rentals" were not reasonable rent payments for the use of this property but, instead, constituted yearly payments upon the purchase price of the property.

2. *PROVISIONS AND ANALYSIS OF THE SO-CALLED "LEASE AGREEMENT AND PURCHASE OPTION" AND THE "MEMORANDUM AGREEMENT."*

(a) *Provisions of the so-called "Lease Agreement and Purchase Option."*

The agreement contains the following provisions, which are summarized below as they appear by paragraph numbers in the agreement itself:

Par. 1: The appellees "leased" the property described therein (ie, the entire Buffalo Block) to Buttrey Co., subject to existing leases, for a ten-year term.

Par. 2: Buttrey Co. agreed to pay "rent" in the sum of $19,000 a year, the first year's "rental" being paid at the time the agreement was executed.

Par. 3: Buttrey Co. agreed to keep the premises in good repair and not to commit waste.

Par. 4: Buttrey Co. agreed to insure the property against damage or loss by fire for not less than $175,000 and to pay the premium thereon. The appellees were to be paid the proceeds of the policy in case of fire as their interest may appear, provided that in the event of a total loss, Buttrey Co. had the option of acquiring title to the property by paying $75,000 plus the remaining "rentals" for the full ten-year term less the insurance proceeds.

Par. 5: Buttrey Co. agreed to take over all existing insurance policies and to pay the appellees for any unearned premiums computed to February 1, 1946.

Par. 6: Buttrey Co. agreed to pay all state, county and city taxes;

Buttrey Co. agreed to pay all fuel, light, power, and water bills;

Buttrey Co. agreed to fully maintain said property at its own cost and expense.

Par. 7: Buttrey Co. was given the right to assign the "lease" and to "sublet" the premises, and any rentals for "subletting" after February 1, 1946 belonged to Buttrey Co.

February 1, 1946 was the date fixed for turning possession of the premises over to Buttrey Co.

Par. 8: Buttrey Co. was given the right to make alterations and improvements. Before any major improvement or remodeling, the consent of the appellees was required. Buttrey Co. was given the right to remove any fixtures or movable property placed in the premises by them.

Par. 9: Provides for quiet and peaceful possession of the premises.

Par. 10: In case a fire renders the premises untenantable and Buttrey Co. elects to restore the premises to tenantable condition, the insurance proceeds shall be released to Buttrey Co. for this purpose. In the event of fire, Buttrey Co. agreed to notify the appellees in order that they may inspect the damage. If Buttrey Co. does not elect to restore the premises to tenantable conditions, then the "lease" terminates six months after the fire, unless Buttrey Co. exercises the option of purchase under the acceleration clause in Paragraph 4 above.

Par. 11: Buttrey Co. agrees to comply with sanitary regulations and ordinances of Montana and Kalispell. If structural improvements are required under the order of public authority, the expense thereof will be borne by the appellees.

Par. 12: Buttrey Co. is given the "option" to

purchase the premises for $75,000 at any time between Nov. 1, 1955 and Jan. 31, 1956, except that it can be exercised sooner if Paragraph 4 applies.

Par. 13: Required the appellees to execute a warranty deed conveying the property to Buttrey Co. and to deliver such deed, together with a copy of this agreement, to the Conrad National Bank of Kalispell with instructions to the bank that said deed be delivered to Buttrey Co. if it exercises the "option" to purchase. Appellees agreed to stand the expense of obtaining an abstract of title which would be held in escrow by the Bank with the warranty deed and a copy of this agreement. It was agreed that if the "option" was not exercised, the bank would return the deed and abstract to the appellees. If the examination of the abstract showed that the title was defective but could be cured, the appellees agreed to correct such defects at their own expense. It was agreed that any and all charges imposed by the Conrad National Bank incurred as "such escrow agent" for its services hereunder should be borne and paid by Buttrey Co.

Par. 14: The appellees were given the right to re-enter and lease the premises if Buttrey Co. vacated or abandoned the premises. If appellees elected to re-enter, it was agreed that any cost of repairs, etc. would be borne by Buttrey Co. and Buttrey Co. agreed to pay, at the end of every year, any deficiency in the yearly "rental" payments.

Par. 15: It was agreed that the heirs, personal representatives, successors and assigns of both parties would be bound by this agreement.

The agreement was duly signed and the signatures of all parties were acknowledged.

(b) *Provisions of the "Memorandum Agreement."*

The "Memorandum Agreement" was executed by the same parties on February 1, 1946 and it was acknowledged on that date. It provided that the ap-

pellees, "in contemplation of the exercise of said option," agreed to immediately deliver to the Conrad National Bank of Kalispell, Montana an executed warranty deed conveying the property to Buttrey Co. and also an abstract of title covering said property showing that the appellees were vested with a merchantable title as of January 14, 1946, the date the so-called "Lease Agreement and Purchase Option" was executed.

(c) *Discussion of the Agreements.*

Under Paragraph 1 of the so-called "Lease Agreement and Purchase Option," the appellees "leased" the property to Buttrey Co. for an agreed "rental" of $19,000 a year, a figure greatly in excess of a fair and reasonable rental.

Pursuant to Paragraph 2, Buttrey Co. was to receive the rentals from Safeway Stores and the second story offices after February 1, 1946. If Buttrey Co. were really only leasing or renting the space formerly occupied by the Flathead Commercial Company, there would have been no reason to assign the upstairs' rentals and the rentals from Safeway Stores to Buttrey Co.

Under Paragraph 3, Buttrey Co. agreed to keep the premises in good repair and not to commit waste. This provision is one typically found in a mortgage where the mortgagors have sold property under an agreement providing for the purchase price to be paid over a period of years.

Pursuant to Paragraph 4, Buttrey Co. agreed to insure the property for not less than $175,000 and to name the appellees as the beneficiaries of the insurance policies.

If a total loss occurred, Buttrey Co. had the "option" of acquiring title to the property by paying $75,000 plus the remaining "rentals" for the full term less the insurance proceeds. That is, if a total loss had occurred say one day after the execution of the agreement, the "option" could be "exercised" by making a payment of $71,000 ("option" price of $75,000 plus the remaining "rentals" of $171,000 (total "rentals" of $190,000 of which $19,000 was paid concurrently with the execution of the agreement) less $175,000, the insurance proceeds). Said sum of $71,000 is substantially smaller than the fair market value of the land on the date the agreement was executed. The fair market value of the land on that date was about $116,-875.

If a fire had occurred say one year after the execution of the agreement, the "option" could have been "exercised" by making a payment of $52,000. If a fire had occurred two years after the execution of the agreement, the "option" could have been "exercised" by making a payment of $33,000; if a fire had occurred three years after the execution of the agreement, the payment would have been $14,000; and if a fire had occurred four or more years after the execution of the agreement, the "option" could have been "exercised" by paying $0.

There was no question under the above formula that the "option" would be exercised, even if a fire occurred the day after the agreement was signed. That is, the "option" price under the above formula was always substantially less than the fair market value of the land. As shown

above, four years after the agreement was executed, the "option" price was $0 in case of a fire.

This provision of the agreement also shows that the "option" price was not a realistic and bona fide figure representing the fair market value of the property. If the "option" price of $75,000 had actually represented the fair market value of the property, there would have been no reason to require Buttrey Co. to pay all of the remaining rentals for the full 10-year term in addition to the $75,000 in order to exercise the "option."

In Paragraph 5, the appellees assigned all of their existing fire insurance policies to Buttrey Co., which is a usual provision in sales contracts.

In Paragraph 6, Buttrey Co. agreed to pay the state, county, and city taxes. In addition, Buttrey Co. agreed to pay all fuel, light, power, and other bills. These expenses are those normally assumed by a purchaser of property.

In Paragraph 7, Buttrey Co. had the right to assign or sublet the premises. They could, therefore, freely assign or sell their interest in this property. This provision is typical in sales contracts whereas, it is a common practice in leases to provide that the lessee can assign the lease only with the consent of the lessor.

In Paragraph 8, Buttrey Co. had the right to make alterations and improvements.

If major remodeling were contemplated, the consent of the appellees was required. This provision is a normal provision inserted to protect a seller before the purchase

price has been fully paid.

Under Paragraph 9, Buttrey Co. was guaranteed quiet and peaceful possession during the full "lease" term.

Under Paragraph 10, Buttrey Co. had the right, if they so elected, to have the insurance proceeds paid to them to make the premises tenantable after any fire loss.

In Paragraph 11, Buttrey Co. agreed to comply with sanitary regulations, etc. Any structural improvements required by public authority would be borne by the appellees. This provision is in the nature of a warranty by them that the premises were suitable under rules imposed by public authority.

In Paragraph 12, Buttrey Co. had the "option" to purchase the property for $75,000 between November 1, 1955 and January 31, 1956. This "option" price was a totally unrealistic figure. It is not anywhere near the fair market value of the property at the time the agreement was executed and certainly was not a bona fide figure for Federal income tax purposes. It was, of course, from a practical businessman's point of view, an absolute certainty that Buttrey Co. would "exercise" its "option." Indeed, Buttrey Co. directors and officers would have been grossly negligent if the "option" had not been "exercised" after building up such a substantial equity in the property in the form of yearly "rentals." The "Memorandum Agreement" provides that the parties contemplated exercising the "option" and Mr. Elliot testified that he knew that Buttrey Co. would exercise its "option." The "option" was, of course, "exercised"

on November 5, 1955. It is significant that the "option" could not be "exercised" until November 1, 1955; that is, it was not exercisable until all of the "rentals" totaling $190,000 had been paid for the full 10-year period.

Pursuant to Paragraph 13, the appellees executed a warranty deed conveying the property to Buttrey Co. The appellees agreed to pay the expense of obtaining an abstract of title. The deed and abstract were placed in escrow with the Conrad National Bank. All of the charges of such escrow agent were borne and paid for by Buttrey Co.

In the "Memorandum Agreement" it was provided that the appellees would place an abstract of title showing that they were vested with merchantable title as of January 14, 1946, the date the so-called "Lease Agreement and Purchase Option" was signed. That is, Buttrey Co. accepted title as of January 14, 1946.

Under Paragraph 14, the appellees had the right to re-enter if Buttrey Co. vacated or abandoned the premises.

In Paragraph 15, it was agreed that the heirs, assigns, and personal representatives were bound by this agreement.

3. *LEGAL AUTHORITIES.*
Watson v. Commissioner, 62 F. 2d 35 (9th Cir. 1932), *aff'g.,* 24 B. T. A. 466 (1931).

Prior to 1923, Mr. Watson had been engaged in operating a bus line between Los Angeles and Santa Ana, California. His property consisted of 20 busses, furniture and fixtures, operative rights to certain depot facilities, and subleases relating to depot concessions.

In November, 1922, he agreed to sell his bus line for $100,000, but the sale was cancelled after he was informed that the Railroad Commission of California, which had jurisdiction over the matter, would disapprove the sale.

Thereafter, during February, 1923, another agreement was entered into. This agreement was entitled "Lease and Option Agreement." It provided that Mr. Watson leased the property for a term of 47 months for a total rental of $109,900 payable $10,000 upon execution of the agreement, $20,000 after approval thereof by the Railroad Commission, and $1,700 monthly until fully paid. Mr. Watson agreed to transfer and vest in the lessee valid title to one of the 20 busses, purportedly leased thereby, upon the payment of each of said monthly rentals, and should the lessee pay said rentals and otherwise perform the covenants of the lease, then it was given the option of purchasing said properties for the sum of $1.00 cash.

This transaction was approved by the Railroad Commission and Mr. Watson received the initial payment of $10,000. He received $20,000 after the approval of the Railroad Commission and, thereafter, he received all of the monthly rentals of $1,700. When each of the monthly payments were made, Mr. Watson delivered title to one of the 20 busses and at the completion of the monthly rentals all of the property was conveyed and assigned to the lessee.

The 9th Court of Appeals held that, considering the instrument as a whole and what the parties had done, the

legal effect of the instrument constituted a conditional sale.

The Court stated it was free to construe the instrument in question and form its own independent judgment as to its legal effect and that it was not bound by the construction, if any, placed upon it by the Railroad Commission.

The Court said that:

> "We have approached the construction of this agreement under the rule recognized by the Supreme Court in Heryford v. Davis, 102 U. S. 235, 244, where the Court said: ' . . . (it) is not to be found in any name which the parties may have given to the instrument, and not alone in any particular provisions it contains, disconnected from all others, but in the ruling intention of the parties, gathered from all the language they have used. It is the legal effect of the whole which is to be sought for. The form of the instrument is of little account.' "

The Court said that the so-called "rentals" were not intended to represent rent but were payments on account of the purchase price. The Court said that the option clause was meaningless from a practical point of view when the instrument as a whole was considered.

> *Oesterreich v. Commissioner,* 226 F. 2d 798 (9th Cir. 1955).

Plaintiff acquired three adjoining lots in Beverly Hills, California in 1926. Under date of September 11, 1929, the plaintiff entered into an agreement entitled "lease" with the Wilshire Amusement Corporation. The plaintiff is referred to as the lessor and the corporation is referred to as the lessee. The agreement also provided for payments called rent to be paid by the lessee.

The lessee agreed to pay the lessor total rent of $679,-380 payable in monthly installments for a period of 67 years and eight months beginning September 1, 1929 and ending the last day of April, 1997. The rental schedule provided for an annual rental of $7,500 for the first 10 years, $12,000 for the succeeding 18 years, and amount becoming progressively smaller so that the rental for the 68th year was $7,500. The lessee agreed to pay all taxes and similar charges on the property. The lessee agreed to erect a new building on the premises to cost not less than $300,000 and to be completed not later than July 1, 1930. The lessor agreed to join in the execution of notes or debentures and in a deed of trust or mortgage covering the leased premises to secure a loan not to exceed $225,000 to be used in constructing the building. The lessee agreed to take out adequate fire insurance on the building and insurance to protect lessor from claims arising out of the use of the premises. The agreement states that the lessee proposes to sublease a portion of the building for theatre purposes. The lease could be assigned by the lessee upon the terms stated therein and such an assignment would release the lessee of further obligations under the lease. The lessor could declare the lease terminated in case of default continuing longer than a period stated in the lease. The lessee had the right, but was not bound, to tear down any building which might be built on the premises for the purpose of reconstruction. Any such replacement was to cost not less than $325,000.

Another paragraph of the lease provided that, when

the lease expired and all the conditions had been met, the lessor agreed that she would convey the property to the lessee upon receipt of the sum of ten dollars.

The lessee paid the taxpayer $12,000 in each of the years 1945 and 1946 in accordance with the agreement and entered the amounts so paid as rental expense. The plaintiff, on her returns for 1945 and 1946, reported the $12,000 as income from rents. She received a letter from an Internal Revenue Agent in Charge indicating overpayments in her income tax for 1945 and 1946, and enclosing a report in which it was stated that she had reported rental income of $12,000 for the years 1945 and 1946, but investigation showed that the agreement under which these payments were made was "not a lease, but in effect an installment sale of realty under Section 44(b) of the Internal Revenue Code," and she had, therefore, overstated her income for each year by $6,206.91 in that connection. She received another letter from the same source dated July 26, 1949 in which the agent reversed his previous conclusion.

The 9th Court of Appeals stated that the sole issue is whether the agreement is a lease or a contract for the sale of land and the Court observed that in making determinations of this sort, the courts commonly consider the intent of the parties and the legal effect of the instrument as written.

The Court said it was well settled that calling such a transaction a "lease" does not make it such if, in fact, it is something else and, to determine just what it is, the

courts will look to see what the parties intended it to be. Both parties have at all times referred to the agreement as a lease and they have treated the payments as rental income and rental expense respectively. However, the Court said the test should not be what the parties call the transaction nor even what they may mistakenly believe to be the name of such transaction. The Court said that what the parties believe the legal effect of such a transaction to be should be the criterion. The Court said that if the parties enter into a transaction which they honestly believe to be a lease but which in actuality has all the elements of a contract of sale, it is a contract of sale regardless of what they call it or treat it on their books. *The Court said that we must look to the intent of the parties in terms of what they intended to happen.*

The Court said that it is clear that it was intended that title to the premises was to pass to the lessee at the end of the 68-year term. The Court said that what the parties intended and the legal effect of the transactions were one and the same and that the intent of the parties should not be considered apart from the legal effect of the agreement.

The Court cited Section 23(a) (1) (A) of the 1939 Internal Revenue Code and said that if the lessee is either taking title to the property or has acquired an equity, it cannot treat the payments as rental expense. The Court said there can be no doubt that the lessee is acquiring title to the premises since it can acquire property now worth $100,000 for $10.00.

The Court distinguished *Benton v. Commissioner,* 197 F. 2d 745 (5th Cir. 1952), on the ground that in the *Benton* case the option price constituted full consideration for the premises or goods acquired and that it was always questionable whether or not the option would be exercised. Further, in the *Benton* case, the rental payments were reasonable in amount.

In conclusion, the 9th Court of Appeals held that the effect of the transaction was that the plaintiff had made a sale of property and was entitled to treat the proceeds as long-term capital gains. The Court relied upon the following cases:

Judson Mills v. Commissioner, infra; Taft v. Commissioner, infra; Helser Machine & Marine Works v. Commissioner, infra; Chicago Stoker Corp. v. Commissioner, infra.

Haggard v. Commissioner, 24 T. C. 1124 (1955).

Petitioner was engaged in operating a ranch in Arizona. In early 1948, he owned 1340 acres, some of which adjoined acreage owned by John Butler. On Feb. 9, 1948, Butler contacted the petitioner to ascertain if he was interested in purchasing 160 acres of farm land for $48,000. Petitioner had formerly tried to purchase the same property for approximately $100 to $150 per acre.

After some discussion, Butler and petitioner went to the office of petitioner's attorney who suggested that the transaction be handled by the execution of a "lease" under the terms of which petitioner would rent the property for the balance of 1948 for $10,000 and $12,000 for 1949

and the petitioner would have the "option" to purchase the acreage after January 1, 1949, and before January 10, 1950 for $24,000. A separate consideration of $2,000 was given for the "option."

In 1947, the fair or reasonable rental for the property would have been from $3,000 to $4,000 a year and, in 1948, it would have been about $5,000 a year.

Petitioner treated the sum of $12,000 paid to Butler on January 1, 1949 as rental expense pursuant to the "lease" and deducted this amount from his gross income.

The Court stated that the sole issue in the case is whether the so-called "rental" payment was in fact a payment of rent under the "lease" and deductible as such, or a partial payment of the purchase price of the property.

The Court held that the payments were not deductible. The Court said:

> "The principle extending throughout the cases heretofore decided by us on like issues is that where the "lessee", as a result of the "rental" payment, acquires something of value in relation to the over-all transaction, other than the mere use of the property, he is building up an equity in the property, and the payments do not, therefore, come within the definition of rent in Section 23(a) (1) (A), supra."

The Court said that Butler would not have considered making an outright sale for $24,000 and that it was likewise clear that the payments in 1948 and 1949 were in excess of the fair rental value of the property and were fixed at amounts which, when added to the option payment of $2,000 and the ultimate "sale price" of $24,000,

would equal the $48,000 which he wanted for the property.

The Court said that a significant aspect of the over-all transaction indicative of petitioner's intent to acquire an equity interest in the property is the fact that under the "lease", the aggregate "rental" payments constituted 91% of the purchase price stated in the "option" and they also constituted about 46% of the total consideration passing from the petitioner to Butler.

On December 6, 1956, the 9th Court of Appeals affirmed the Tax Court *per curiam (241* F2d *288).*

In reviewing the Tax Court decision, the 9th Circuit noted that two documents were entered into between one John Butler and the taxpayers. The form of these two instruments was to lease 160 acres of land to the taxpayers during the latter part of 1948 for $10,000, in 1949 for $12,000, and to grant an option for $2,000 cash to purchase the land after January 1, 1950, and before January 10, 1950, for $24,000.

The 9th Circuit said that the net effect of these two documents was to confer an equity in the property to the taxpayers and that the Tax Court was correct in so holding. The Court said that the intent of the parties was perfectly plain and that the bare fact that one of the documents was drawn in lease form is of no consequence. The Court said that "the purpose of the contracts was clear, and, therefore, the tax consequences are well settled."

Holeproof Hosiery Co. v. Commissioner, 11 BTA 547 (1928).

On July 27, 1921, the petitioner, as lessee, entered into four lease agreements with a textile company. Each lease provided for rent to be paid on four machines manufactured and owned by lessor. The rent to be paid was $800 a month for the four machines plus the cost of fire insurance thereon. The lease term was 30 months. The total cash rental was therefore $24,000.

The four machines were valued at $26,650.

The lessee could not sell or remove the machines to a new location without the consent of the lessor.

The lessee agreed to keep the machines in good repair.

The lessee agreed that no alterations would be made without the written consent of the lessor.

The lessee agreed not to sell the machines without the written consent of the lessor.

The lessee agreed not to assign the lease or sublet or in any way dispose of the leased property.

The lessee agreed to return the machines in good condition upon the termination of the lease.

Upon the termination of the lease term, the lessee had the option of purchasing the four leased machines for $5,677.26. The lessor agreed to execute a bill of sale if the option was exercised.

The lessee, in case the machines were lost or destroyed, was required to pay the lessor the stated value of the machines, with interest, less the rent previously paid.

The lessor had the right of inspection.

The lessee was to insure the machines in the name of the lessor and pay all taxes assessed and levied against the leased property.

The machines mentioned in the leases were delivered to the petitioner and installed several months after July 27, 1921. They were still in use in January, 1927.

The petitioner claimed, as a deduction for rent on these 16 machines for the year 1921, the amount of $13,-060, which amount the Commissioner disallowed as a deduction on the ground that it represented a capital expenditure.

Held: "Rent" deduction disallowed.

The Court cited from what is now Section 23(a) (1) (A) of the 1939 Internal Revenue Code to the effect that a deduction is allowed for rentals or other payments required to be made as a condition to the continued use or possession of property to which the taxpayer has not taken or is not taking title, or in which it has no equity.

The Court said:

> "The evidence in this case indicates that at the end of the year 1921 the petitioner had a substantial equity in these machines. We do not know the life of the machines, but we do know that they were still in use five years after the taxable year in question. We do not know at what amount the machines could be rented on the open market, but we know that the total amounts to be paid under the lease agreements before the title to the machines was to pass to the petitioner exceed but slightly the stated value of the machines, and it is inconceivable that the petitioner was not acquiring something of value, that is, a certain equity in the machines, with each payment made in accordance with the agreement. The statute does not allow the deduction claimed."

Smith v. Commissioner, 20 B. T. A. 27 (1930); *Shannon v. Commissioner,* 20 B. T. A. 27 (1930).

A partnership entered into a lease agreement involving a building. The agreement was to be in effect for a 20-year term. Shannon, as lessee, agreed to pay the partnership $1,000 a month during the full term of 20 years. He also agreed to assume and pay as "additional rental" the interest on an existing loan of $60,000 on the property.

All taxes and fire insurance premiums were to be paid as "additional rental" by the lessee.

Lessee agreed to keep the building in good repair and to comply with all improvements and changes recommended by the insurance associations.

If the property was damaged or destroyed by fire, the insurance collected by the partnership "as owners thereof" was to be applied to the purpose of rebuilding, but the lessee was required to continue the rental payments. The lessor, however, was entitled to any recovery for such damage which the partnership might obtain.

The lessee was given the right to make such improvements in the building and premises as in his judgment he deemed necessary to the full enjoyment thereof.

The lessor had the right of entry upon the premises.

The lessee had the right to "sublet" the property.

The purpose and intent of the agreement was recited to be that the lessee pay all amounts necessary to yield $1,000 per month net to the partners "as rental."

In case the lessee performed all of the obligations of the agreement and, in addition thereto, paid the additional sum of $10.00 to the partners, they obligated themselves to execute and deliver to him a fee simple deed to the

property. The partners also obligated themselves to execute a fee simple deed to the property and deposit it in escrow with a bank to be held by the bank for delivery when the agreement had been fully complied with.

This case involved the income tax liability of both the lessee (Shannon) and one of the partners (Smith).

Held: The Court, after citing cases, held that the relationship between the parties was not one of lessor and lessee, but of vendor and vendee; the transaction was a conditional sale and the payments made were not rent, but were payments on the purchase price. The Court said the execution and deposit of the deed in escrow further strengthened their views for the grantor had no control or power over the escrow deed and could no more countermand the delivery thereof than of an absolute deed, and it is always in the power of the grantee to entitle himself to the deed by performing the conditions in the agreement.

Helser Machine & Marine Works, Inc. v. Commissioner, 39 B. T. A. 644 (1939).

Under an agreement called a lease, dated April 1, 1935, the petitioner became the lessee, from May 1, 1935 until April 30, 1945, of a piece of real property and he agreed to pay rent in monthly payments of $160 each. The lease provided that at any time the lessee paid the total rentals of $19,200 he would be entitled to receive a warranty deed to the property.

Petitioner deducted the "rent" paid in 1935 on his 1935 tax return.

Held: Deduction disallowed. The Court cited what is now I. R. C. Sec. 23(a) (1) (A) and said that from this statutory language it is clear that a taxpayer does not establish a deduction merely by showing that the amount paid is called rental, or that, regardless of nomenclature, it is rental in that the consideration for its payments is to some extent the possession, use and occupancy of the property. The only rental which may be deducted is that "of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

Taft v. Commissioner, 27 B. T. A. 808 (1933).

A corporation was the owner of a certain lot and building thereon. Petitioner made a written offer to

> "purchase the property for $185,000 on the following terms: $50,000 in cash and $25,000 at the end of 5 years and an additional $25,000 at the end of 10 years and the balance of $85,000 to be the privilege of purchase at the end of the lease."

Thereafter, the parties executed an agreement called a lease and the lessor received a payment of $50,000 under the lease, and the lessee agreed to pay $6,750.00 annually. The lessee had the option to purchase the property at any time upon payment of the sum of $135,000 and the payment of all arrearages under the lease. The lessor agreed to execute a warranty deed if the petitioner elected to buy the property.

Lessee agreed to pay all taxes, assessments and insurance and such payments were to be made even if the premises were destroyed by fire or otherwise. Lessee agreed not to commit waste or to use the property for any

unlawful purposes, nor assign the lease without written consent of the lessor.

Lessee agreed to keep the building insured for $20,000 and if said building were destroyed by fire, etc. the recovery thereon was to be used to restore the building or, at the option of the lessee, paid to the lessor as a partial payment on account of the privilege of purchasing the property.

The corporation's president was of the opinion that the "privilege of purchase" was actually an obligation to purchase and this was the purpose and effect contemplated by him at the time. The corporation's tax return for the year in which the agreement was executed was filed on the basis that a sale and not a lease resulted from the agreement for payment of its federal income tax burden, and its tax liability for that year was determined on that basis.

Petitioner contended that the transaction was not a sale, but only a lease for 15 years and that, therefore, he was entitled to have the $50,000 initial payment for the lease amortized over the life of the lease and deducted from gross income.

Held: The agreement constituted a sale and no deduction for rent is allowable.

The Court said that its purpose was to determine the true character of the transaction. Calling it a "lease" does not make it such, if, in fact, it is something else. Considering all the facts and circumstances of this case, the Court held that the $50,000 payment could not be amor-

tized. The Court was influenced by the fact that the lessee had originally offered to buy the building and the lease agreement was worked out along the lines of the prior offer to buy.

Judson Mills v. Commissioner, 11 T. C. 25 (1948) (A).

Petitioner was a manufacturer of cotton and rayon textile products. The machinery and equipment was somewhat obsolete in 1938 and it was decided to take steps to modernize such property.

New equipment was installed under three separate agreements whereby the manufacturer, designated the lessor, purported to lease the equipment for stipulated monthly payments, termed rentals, to petitioner, designated lessee. Prior to making these agreements, petitioner and the manufacturer reached a precise understanding as to how the recurrent payments should be computed and the factors entering into the totals payable, and their understanding was set forth in correspondence between them.

The first agreement provided for a rental aggregating $25,958.64 for a two-year period, of $25,958.52 for the next three years, and of $6,198.87 on the exercise of an option.

Lessee agreed to keep the machine safe and to carefully use it; to keep it insured; to pay all taxes; not to remove it without the lessor's consent; to keep the machine in good repair and to buy all necessary replacement parts from the lessor; to return the machine in good condition at the end of the lease term; and if the lessee de-

faulted, the lessor could terminate the lease and take possession of the property.

Upon the termination of the lease, the lessee had the option to purchase the property for $6,198.87. If the option were exercised, the lessor agreed to execute and deliver to the lessee a bill of sale for the machinery.

Th second lease agreement was for a term of 4½ years unless previously terminated or extended. The lessee agreed to pay rent of $125,086 in monthly installments.

The lease provided that the machines remained the sole and exclusive property of the lessor and that the lessee had no right of property or equity therein, but only the right to use the same in the manner and upon the conditions set forth in the lease.

If the lessee defaulted, all payments becoming due subsequent to such default at the option of the lessor became immediately due and payable.

The lessee had the option to buy the machines at the end of the lease term for $12,850.

The third lease agreement was for a seven year term. The aggregate rent payable was about $184,644.

The lessee had the option to purchase the property at the end of the lease term for $18,950.

The remainder of the third agreement was substantially the same as the second agreement.

Petitioner ultimately exercised the option of purchase in all three agreements.

Petitioner deducted $30,786.78 as machinery rentals in its 1940 tax return.

Held: Petitioner's payments under the three agreements were not rentals of machinery, but constituted the purchase price thereof. The Court said that by the payments the petitioner made on the machinery it acquired an equity in the property and thence the "rental" payments were not deductible under I. R. C. Sec. 23(a) (1) (A). The Court relied on the *Holeproof Hosiery Co. v. Commissioner, supra; Smith v. Commissioner, supra;* and *Helser Machine & Marine Works, Inc. v. Commissioner, supra.*

Truman Bowen v. Commissioner, 12 T. C. 446 (1949) (A).

A partnership furnished equipment to the U. S. Government during 1941 for use at construction work to which the Government took title during 1942. The value of each item of equipment was agreed upon. The agreement was called an "equipment rental agreement." The monthly payments were treated as equity of the Government under the agreement. Title was to pass to the Government when the monthly payments equalled the agreed value plus charges for interest at the rate of 1% of value per month plus freight. If the monthly rentals did not equal the agreed value upon completion of specific projects, the Government could take title upon completion of work by a further payment which, added to the monthly payments, would equal the agreed value, plus 1%, plus freight.

Held: The monthly payments were sales proceeds and did not constitute rent income under I. R. C. Section 22(a).

The Court said that the determination of whether an agreement is a lease or a conditional sales contract is controlled neither by form nor by the use of the terms "lease" and "rent". It is necessary to look through the form to the substance and the courts will always look to its purpose, rather than to the name given to it by the parties. The Court said that the contract had to be construed in accordance with what the evidence shows to have been the purpose of the entire agreement.

The Court further said:

> "The agreement resembled, therefore, the type of agreements where monthly payments are to be made for a stated period, and at the end of that period a small additional payment is to be made to acquire title. See, for example, the following cases where the period of the agreement was for a stated number of months or years, and, at the end of the period, if monthly payments were not in default, the "lessee" could acquire title to property upon payment of a small additional amount: *Holeproof Hosiery Co., supra;* and *Judson Mills, supra,* where the contracts were held to be something other than an ordinary lease, the holding as to the nature of the monthly payments being that they were not rent for purposes of the income tax. See, also, *Helser Machine & Marine Works, Inc., supra.*"

1939 I. R. C. Section 23(a) (1) (A) defines rent as payment for the use or possession of property. It excludes from the term "rent." payments for the use or possession of property to which the taxpayer is taking title, or in which he has an equity. The Court concluded that the payments in this case were not rent for Federal income tax purposes.

Chicago Stoker Corp. v. Commissioner, 14 T. C. 441 (1950).

The President of the Eddy Stoker Corp. learned in 1941 that the Whiting Corporation wanted to dispose of its stoker division. He learned that the stoker division had been losing money and that Whiting Corporation wanted someone to carry on this business who would provide service and parts for stokers which Whiting Corporation had sold in the past. He did not want to buy the business because he thought the cost would be too much for him to finance and also he did not want to pay anything for it until he could learn whether or not he could operate it profitably.

Whiting Corporation and Eddy Stoker Corp. entered into an agreement dated March 13, 1941, whereby Whiting agreed to sell the stoker business. Eddy Corp., although described as the "buyer", did not expressly agree to buy, but agreed to pay royalties in the stokers manufactured and sold in amounts set forth in the agreement.

One of the provisions in regard to royalties provided that when the total of the royalties paid by the "Buyer" to the "Seller" amounted to $70,000 no further royalties were to be paid and the title to the business and property shall vest in the "Buyer."

A minimum royalty of $2,500 a year was payable for the first two years.

Eddy Corp. was not committed to make any effort to sell stokers and it could at any time return the business and property to Whiting and thereby be released from

further liability under the agreement. The title to the business and property was to remain in the seller until the $70,000 of royalties was paid in full.

Eddy Corp. organized a new corporation, the petitioner, and assigned the agreement to it. The petitioner made total payments of $30,000 to Whiting prior to September 2, 1944, based on sales of stokers. In 1942 and again in 1944, the petitioner gave serious consideration to the possibility of returning the stoker business to Whiting.

The petitioner made a final payment of $40,000 to Whiting in September, 1944, and on September 2, 1944, sold the business to another corporation.

The petitioner, on its returns for 1941 through 1942 deducted the payments made to Whiting in those years. The Commissioner disallowed the deductions on the basis that they were not deductible under 1939 I. R. C. Sec. 23(a) (1) (A), and determined a gain from the sale of the business in 1944, using $70,000 as the cost of the business.

Held: For the Commissioner. Deductions disallowed.

The Court relied on *Judson Mills v. Commissioner, supra;* and *Truman Bowen v. Commissioner, supra.* The Court said:

> "The petitioner by reason of the payments here in question was able to use the property during the taxable years. The payments were made unconditionally in the sense that they were never going to be returned to the petitioner. The petitioner was not re-

quired to buy the property. The arrangement was that when the payments amounted to $70,000 the petitioner would receive title to the property. The petitioner was to have no legal title to the property until the payments equaled $70,000 and was never to have any title to the property unless the payments equaled $70,000. The evidence indicates, that, if royalty payments had been made in accordance with the agreement, it would have been about 15 years before they would have amounted to $70,000. The petitioner on two occasions had seriously considered giving up the contract altogether and returning possession of the property to Whiting.

Cases like this, where payments at the time they are made have dual potentialities, ie., they may turn out to be payments of purchase price or rent for the use of property, have always been difficult to catalogue for income tax purposes. A fixed rule for guidance of taxpayers and the Commissioner is highly desirable, and it is also desirable that the rule, whatever it is, be as fair as possible, both to the taxpayer and the tax collector. If payments are large enough to exceed the depreciation and value of the property and thus give the payer an equity in the property, it is less of a distortion of income to regard the payments as purchase price and allow depreciation on the property than to offset the entire payment against the income of one year. That is the rule laid down in the *Judson* case and it finds support in Section 23(a) (1) (A). The payee, meanwhile, is not reporting the payments, since they are purchase price rather than rent, and his gain or loss can be determined at the time of the final outcome of the transaction. The *Judson Mills* and *Truman Bowen* cases, being the most recent ones and seeming to establish the more equitable rule, will be followed herein and the Commissioner's disallowance of the deductions will be allowed to stand."

For other cases holding that agreements which were entitled leases and which provided for rent payments which were actually sales or conditional sales contracts see:

Goldfield of American, Ltd. v. Commissioner, 44 B. T. A. 200 (1941);

Lodzieski v. Commissioner, 3 T. C. M. 1056 (1944);

Rotroite Corporation v. Commissioner, 117 F. 2d 245 (7th Cir. 1940);

Lemon v. United States, 115 F. Supp. 573 (D. C. Va. 1943);

Browning v. Commissioner, 9 T. C. M. 1061 (1950);

Renner & Movius, Inc. v. Commissioner, 9 T. C. M. 451 (1950);

McWaters v. Commissioner, 9 T. C. M. 507 (1950);

Graves v. Commissioner, 11 T. C. M. 467 (1952).

4. *SUMMATION OF APPELLEES' CONTENTIONS.*

Mr. Thomas Elliot was the operator of the Flathead Commercial Co. in Kalispell for a number of years prior to January of 1946. In addition, he and his brother owned the business property known as the Buffalo Block in Kalispell.

Due to reason of his health, Mr. Thomas Elliot desired to sell the Flathead Commercial Co. and this was done in December of 1945 and January of 1946. He also desired to retire from the operation of the Buffalo Block and, therefore, on January 14, 1946 he and his brother entered into the so-called "Lease Agreement and Purchase Option." On February 1, 1946, the supplemental "Memorandum Agreement" was executed by the same parties.

These agreements were prepared by the attorneys for Buttrey Co. and were executed in Kalispell, Montana. The plaintiffs were not represented by a lawyer and they incurred no legal fees in this matter.

The agreements were fully carried out and on November 5, 1955 the final payment, called an "option," was made and the deed, abstract, and title opinion rendered as of January 14, 1946 were delivered to Buttrey Co. by the escrow holder who was paid its fee by Buttrey Co.

The provisions of the agreements are set forth and discussed hereinabove. It seems clear after analysing the agreements that it was the intention of the parties that Buttrey Co. was acquiring an equity in the property and that the parties contemplated the payment of the final $75,000 payment labeled an "option" price. The purpose of the agreement and the intention of the parties was to transfer title and to contract for sale.

The comparison between the appellees gross rental income of $16,500 a year and its net rental income of some $5,000 a year prior to entering into this agreement and their net yearly "rental" income of $19,000 after the agreement was signed is further evidence that the $19,000 payments were not true rent payments for the use of this property.

The comparison between Buttrey Co.'s offer to rent the first floor and basement for some $14,000 a year and the $19,000 a year payments under this agreement whereunder Buttrey Co. also agreed to pay all the taxes, insur-

ance, and other expenses, which they would not have incurred under an ordinary lease agreement, less a partial offset for the second story office rentals which it could receive also indicates that Buttrey Co. was buying the property rather than renting it.

The "option" price of $75,000 was greatly below the value of the property in 1946. Mr. Thomas Elliot testified that in his opinion the property was worth in excess of $200,000 at the time the agreement was signed. Mr. S. Geddes, an expert real estate appraiser, stated that the value of the land alone was worth $116,875 in 1946 and he stated that in his opinion the building was worth at least $175,000 at that time. In its Findings of Fact, the District Court found that the property was worth approximaely $200,000.

It is significant that Buttrey Co. did not have the right to exercise the "option" at any time. That is, it could only be exercised on a date after Buttrey Co. had paid the yearly payments of $19,000 for 10 years. It is submitted that if the "option" price had been a bona fide fair market price, it would have been unnecessary to provide that it could not be exercised until the end of the term and then only after Buttrey Co. had paid total "rentals" of $190,000.

It is further noted that Buttrey Co. accepted the title opinion as of January 14, 1946. That is, they accepted title to the property as of that date.

It is also noted that no one testified against the appellees in these cases nor were their witnesses cross-

examined.

It seems clear that, under the facts of these cases, the agreement constituted a conditional sales argreement and was so intended by the parties and that the appellees are entitled to treat the yearly payments thereunder as proceeds from the sale of the property involved rather than as rental income subject to ordinary income tax rates.

It is clear that the courts will look to the substance rather than the form in order to determine the Federal income tax consequences of an agreement of this kind. This is the universal rule and it has been applied in three cases in the 9th Court of Appeals, *Watson v. Commissioner, supra; Oesterreich v. Commissioner, supra; Haggard v. Commissioner, supra.*

The Tax Court has attempted to distinguish leases from sales by considering the intention of the parties as such intention can be determined by an objective test based upon the size of rental payments, the option price, and the value of the property. See *Judson Mills v. Commissioner, supra; Chicago Stoker Corp. v. Commissioner, supra; Taft v. Commissioner, supra; Helser Machine & Marine Works, Inc. v. Commissioner, supra; Holeproof Hosiery Co. v. Commissioner, supra.*

The Tax Court has held that the lessee has an equity if the option price is substantially less than the value of the property or that the option price represents a relatively small proportion of the total consideration paid. In *Chicago Stoker Corp. v. Commissioner, supra,* the court said:

> "If payments are large enough to exceed the depreciation and value of the property and thus give the payer an equity in the property, it is less of a distortion of income to name the payments as purchase price and allow depreciation on the property than to offset the entire payment against the income of one year."

In the *Oesterreich* case, the 9th Court of Appeals cited the above cases with approval, and it is clear that under the rule of these cases that the agreement in this case constitutes a conditional sales agreement.

In *Benton v. Commissioner,* 179 F. 2d 745 (5th Cir. 1952), the 5th Court of Appeals stated that in determining the intent of the parties, the objective factors are only some of the considerations to be taken into effect in determining the ultimate question of whether the agreement constitutes a lease or a conditional sale. In the *Benton* case, the court found as facts that the rental payments were reasonable in amount and that the option price was a realistic figure in view of the circumstances in the case. Therefore, the court held that the agreement in that case was a true lease and that the payments made by the lessee were deductible.

In the *Oesterreich* case, the 9th Court of Appeals distinguished the *Benton* case on the grounds that, in that case, the option price constituted the full consideration for the property acquired. It is submitted that the cases at bar are distinguishable from the *Benton* case for the same reason. The "option" price of $75,000 represented at the most only about 35% of the value of the Buffalo Block at the time the agreement was entered into. The

balance of the purchase price was made up in the form of the yearly "rentals."

In *Haggard v. Commissioner, supra,* the "option" price was $24,000 and it represented approximately 50% of the value of the property. The Tax Court noted that the aggregate of the "rental" payments constituted 91% of the purchase price stated in the "option" and that the total annual "rental" payments was about 46% of the total consideration passing to the seller.

In the cases at bar, the "option" price of $75,000 was only approximately 35% of the value of the property; the "rental" payment of $190,000 constituted approximately 250% of the purchase price stated in the option; and the total annual "rental" payments were in excess of 70% of the total consideration passing to the appellees.

The 9th Circuit, in the *Haggard* case, said that "the purpose of the contracts was clear, and, therefore, the tax consequences are well settled."

The Courts have held that an instrument is a lease or a sale depending upon whether the parties intend the payments to be made for the use of the property alone, or for title to the property as well as its use during the payment period. If the intention of the parties is merely to enable the payer to use the property, their agreement is a lease. On the other hand if their intention is to enable the payee to use and also to acquire or purchase the property, their agreement is a sale. *E. G. Robertson,* 19 B. T. A. 534, 540 (1930). *Smith v. Commissioner, supra; Taft v. Commissioner, supra; Helser Machine & Marine*

Works, Inc. v. Commissioner, supra; Judson Mills v. Commissioner, supra; Truman Bowen v. Commissioner, supra; Chicago Stoker Corp v. Commissioner, supra; Jefferson Gas Coal Co. v. Commissioner, 52 F. 2d 120 (3rd Cir. 1931).

> "A lease contemplates only the use of the property for a limited time and the return of it to the lessor at the expiration of that time; whereas a conditional sale contemplates the ultimate ownership of the property by the buyer, together with the use of it in the meantime." *In re Rainey,* 31 F. 2d 197 (Dist. Md. 1929).

It is therefore clear, under the facts of these cases and the case law applicable thereto, and in particular under the decisions of the 9th Court of Appeals, that Buttrey Co. intended to and did acquire title to property by making 10 yearly payments each in the amount of $19,000 or a total of $190,000 and by making a final payment of $75,00 on November 5, 1955, at which time the deed, abstract, and title opinion rendered as of January 14, 1946 were delivered to Buttrey Co. by the escrowee who was paid its fee by Buttrey Co. It is likewise clear that the appellees intended to and did sell the property under a sales agreement in consideration for the ten annual payments totaling $190,000 plus the final payment of $75,000.

5. *ANSWER TO ARGUMENT OF APPELLANT IN HIS BRIEF.*

Appellant claims the District Court erred in holding that the appellees sold the property to Buttrey Co. Appellant's argument on this point is not extensive (Appel-

lant's Brief, pages 36-40) and seems to be more in the nature of a technical objection to paragraph number 16 of the District Court's Findings of Fact (No. 15983, R. 86). Appellant states that the question is not one of pure fact and that it is at least a mixed question of law and fact. It is submitted that in addition to the factual quesions, the District Court was well aware of the legal questions and that so far as the ultimate question being a mixed question of fact and law, the District Court's Opinion (No. 15983, R. 73-79) fully discusses the applicable case law as interpreted by the 9th Court of Appeals, and after so doing, the Court appropriately held in the appellees' favor. In addition to paragraph 16 of the Findings of Fact, the Court, in its Conclusions of Law, found that the agreement constituted a sales agreement (No. 15983, R. 88). There is no need to quote at great length from the Court's Opinion, its Findings of Facts and Conclusions of Law. It is submitted that the District Court, which sat as both the trier of the facts and of the law, did not err in either its factual or legal conclusion and it is further submitted that the decision of the District Court must be affirmed.

STATEMENT OF FACTS RELATING TO THE PROCEDURAL QUESTIONS RAISED BY THE APPELLANT.

The appellant has raised two procedural questions, one involving Section 44 of the Internal Revenue Code of 1939 and the other involving a question of "fatal variance" between certain of the refund claims and the

complaints. The facts, insofar as they relate to these issues, are contained in the complaints, in the answers, in the Stipulation of Facts entered into by the parties, and in the oral testimony.

It is noted that both of these issues were raised in the District Court and were rejected by the District Court in Paragraph 18 of its Finding of Fact (No. 15983, R. 87, 88) and in Paragraph 4 of its Conclusions of Law (No. 15983, R. 88).

1. *Facts relating to Section 44 of the 1939 Internal Revenue Code.*

On page 4 of his brief, appellant raises the question of whether the taxpayers may avail themselves of the installment sales provision of the statute (Section 44 of the 1939 Internal Revenue Code) by filing refund claims and bringing suit on that basis for recovery of a part of the taxes paid.

At the outset, appellees emphatically deny that their complaints and law suits are based on Section 44 of the 1939 Internal Revenue Code and they further deny that the District Court in its Opinion and in its Findings of Fact and Conclusions of Law ever referred to Section 44 or in any way based its decision and judgments upon Section 44 of the 1939 Code. The appellees, in their complaints, during the trial, and in their briefs have never attempted to come within the provisions of Section 44.

Appellant, in his statement of facts contained on pages 5 through 13 of his brief, does not set forth any facts

which would lead to the conclusion that the taxpayers are trying to avail themselves of Section 44 of the 1939 Code. It is true that the original refund claims of the years 1946, 1947, 1948, and 1949 for both taxpayers and William G. Elliot for 1950, were based on the ground that the transaction evidenced by the "Lease Agreement and Purchase Option" and the "Memorandum Agreement," constituted a conditional sale of the Buffalo Block property resulting in a capital gain and it is true that said refund claims did include the legal theory that Section 44 was applicable. The supplemental refund claims filed by both taxpayers for 1949 and by William G. Elliot for 1950 and all of the refund claims for later years contained no reference to Section 44 and none of them was based on the legal theory that Section 44 was applicable.

In the paragraph commencing in the middle of page 13 of Appellant's brief, two assumptions are made, neither of which is supported by the facts. Appellant states that the complaints are based on the ground that Section 44 is applicable and that the court's opinion, finding of fact and conclusions of law, and judgments are based on the ground that Section 44 is applicable. It is submitted that neither of these assumptions is correct.

Regarding the complaints (No. 15983, R. 3-12; No. 15984, R. 3-13), it is emphasized that neither of them makes any reference whatsoever to Section 44 nor are they in any way based on the legal theory that Section 44 is applicable in these cases.

In paragraph number (4) of both complaints (No.

15983, R. 3, 4; No. 15984, R. 4) it is provided that these actions arise under Section 117 of the Internal Revenue Code of 1939. In paragraphs numbered (22) through (35) in William G. Elliot's complaint (No. 15983, R. 8-11) and paragraph numbers (22) through (37) in Thomas W. Elliot's complaint, (No. 15984, R. 7-11) certain facts are set forth giving rise to the appellees' causes of action and throughout these paragraphs, it is alleged that the transfer of real property resulted in a long term capital gain under Section 117 of the Internal Revenue Code of 1939 and once again it is emphasized that no allegation or claim was made that Section 44 was or is applicable.

Regarding the court's opinion, findings of fact and conclusions of law, and judgments, the appellant also is in error in stating or inferring that they are based on the ground that Section 44 is applicable.

Counsel for the respective parties in the Stipulation of Facts entered into in both cases (No. 15983, R. 72; No. 15984, R. 51) agreed in paragraph number 23 of the stipulations that if the court held that the agreements in question constituted a sale or conditional sales agreement, then in order to conserve the time of the district court, the parties would submit computations of amounts of overpayments to be entered as judgments, and if the computations differed, the parties would be heard on that matter. Therefore, in view of this stipulation, it was only necessary in the first instance for the Court to determine if the agreements did effect a sales agreement or a true

lease agreement. If the Court so held, the question of their computing the correct overpayment was to be later considered. The Court did, of course, hold that they constituted a sales agreement as distinguished from a lease agreement. In the concluding paragraph of the Opinion (No. 15983, R. 79), the Court called attention of counsel to the stipulation of facts in both cases and particularly to paragraph number 23 of the stipulations which the Court had previously referred to in its Opinion (No. 15983, R. 74). There is absolutely nothing contained in the Court's Opinion stating that Section 44 was applicable in these cases and therefore the appellant is incorrect in so stating.

The Court's Opinion was filed on June 27, 1957 (No. 15983, R. 79) and thereafter, under date of October 31, 1957, counsel for the respective parties in pursuance of the Court's Opinion and also pursuant to paragraph number 23 of the stipulation of fact, entered into a stipulation (No. 15983, R. 91, 92) whereby it was provided that, for the purpose of these actions, the parties agreed upon certain amounts of overpayments by the appellees. It was agreed by counsel that these amounts did not bind either party to any particular legal theory or method of computing the overpayments. The agreement was entered into as a convenience for both parties and for the Court in that it was then no longer necessary to hold a court hearing on the matter of computing the overpayments. After this stipulation was filed, the Court then made and filed its Findings of Fact and Conclusions of Law on

October 31, 1957 (No. 15983, R. 81-88), and Judgments were entered on the same date (No. 15983, R. 89, 90; No. 15984, R. 54, 55). The Court incorporated the stipulation of overpayments into its Findings of Fact and in paragraph 17 thereof the correct amounts of overpayments were deemed to be those contained in the stipulation.

Concerning the Findings of Fact, there is no statement that the Court found Section 44 of the 1939 Code to be applicable and no reference is made to it whatsoever. The Court did find, in paragraph number 18 (No. 15983, R. 87), that the appellees were entitled to the refunds of the amounts agreed upon and further found that there was no fatal variance involved in these cases and that there is no procedural or substantive rule of law which prohibits the making of the refunds. In its Conclusions of Law, the Court in no way stated or inferred that Section 44 was applicable in this case (No. 15983, R. 88). The Court did conclude that the property had been sold and that the installment payments made pursuant to the agreements were subject to long-term capital gain treatment under Section 117 of the 1939 Code and that the appellees were entitled to refund of tax overpayments, the amounts of which were agreed upon in the stipulation made by the parties. Neither do the Judgments in any way refer to Section 44 (No. 15983, R. 89, 90; No. 15984, R. 54, 55). Therefore, the appellant is in error as a matter of fact in his statement that the Court's Findings of Fact, Conclusion of Law, and Judgment are based or grounded on

Section 44.

2. *Facts relating to the alleged "fatal variance" between certain of the refund claims and the complaints.*

The appellant has raised the question on page 4 of his brief as to whether, as to some of the latter years involved, the District Court may entertain suits for recovery based on the ground that the taxpayers were entitled to have their taxes computed under the method set forth in Section 44 whereas the refund claims for those years were based on the ground that gain from the sale was taxable in the year of sale.

To some extent, this issue is tied in with the other procedural question raised by the appellant but nevertheless it is a separate question.

In the appellant's statement of facts contained on pages 5-13 of his brief, he attempts to cover the facts involved in this question on page 12 and 13. However, said statement of facts contains several errors. On page 13, he states that the complaints and the opinion, findings of fact and conclusions of law, and judgment are based on the grounds that the appellees are entitled to report their long-term capital gain on the installment basis contained in Section 44 of the Internal Revenue Code. This is not correct (See *supra,* pages 50 to 55).

It is submitted that no "fatal variance" exists between the refund claims and the complaints and the decision of the District Court. The District Court, in paragraph number 18 of its Findings of Fact (No. 15983, R. 87) found that there was no "fatal variance" between the re-

fund claims and the complaints and the Court further found that no procedural or substantive rule of law prohibited the making of the refund. In its Conclusions of Law (No. 15983, R. 88), the Court held that there was no procedural or substantive rule of law which prohibited judgments from being entered for the refunding of the overpayments.

The original refund claims for 1946, 1947, 1948, and 1949 for both appellees and the original 1950 refund claim for William G. Elliot were filed by the appellees after consultation with an accountant in Billings, Montana. The grounds for these refund claims was that the amounts which had been paid to the appellees during those years under the agreement with Buttrey Co. constituted proceeds from the sale of property subject to long term capital gain taxation rather than rental income. These claims contained the legal theory that Section 44 of the Internal Revenue Code was applicable.

The appellees acknowledge, just as they did in the District Court, that the above refund claims were based on an incorrect legal theory and no attempt was made in the District Court nor is it made herein to have their long-term capital gain computed under Section 44 of the 1939 Internal Revenue Code.

Supplemental refund claims were prepared and filed for the year 1949 by both appellees and in said claims, the appellees abandoned the legal theory that Section 44 was applicable and instead asserted the legal theory that they were entitled to exclude all payments received by them

in 1949 under the agreement with Buttrey Co. Larger amounts of refunds were claimed in the supplemental claims. At the time that said supplemental refund claims were filed for 1949, the statute of limitations for filing refund claims for all of the earlier years had expired. Hence, the appellees were precluded from demanding larger refunds for these years by filing amended refund claims.

The second refund claim filed by William G. Elliot for 1950 and all of the refund claims filed by both appellees for 1951, 1952, and 1953 were based on the legal theory that a completed sale occurred in 1946 resulting in a long-term capital gain, but no claim was made that Section 44 of the 1939 Code was applicable.

It is emphasized that in all of the refund claims involved in these cases that the factual grounds for the refunds were all the same. That is, the factual grounds were and are that the payments received under the agreements with Buttrey Co. constitute sales proceeds and are subject to long-term capital gain treatment. It is true that so far as the *legal theory for computing the taxable gain* is concerned, the latter refund claims do advance a different theory or method. However, so far as the *facts* giving rise to a refund claim or cause of action is concerned, there is no variance and the same basic facts giving rise to a cause of action are contained in all of the refund claims.

The facts which are contained in the refund claims are exactly the same facts upon which the appellees'

causes of action are predicated in their complaints and upon which the trial court held in the appellees' favor. Hence, there could be no "fatal variance" which would preclude the appellees from recovering any of the overpayment for any of the years for which judgments were rendered by the District Court.

ARGUMENTS

1. *The District Court's decision is not based on Section 44 of the 1939 Internal Revenue Code.*

The appellant states on page 14 of his brief that the taxpayers are not entitled to recover in this case on the installment basis of reporting income as provided for in Section 44 of the 1939 Internal Revenue Code and that the District Court erred in entering judgments for the taxpayers on that ground.

This "issue" seems to be an entirely factual one and the appellees will not herein discuss the court cases and other authorities cited by the appellant since they at best raise only moot questions. Appellees deny that the District Court entered judgments based on Section 44 of the 1939 Code. As stated above on pages 50 to 55, there is no reference whatsoever to Section 44 in the complaints or in the District Court's Opinion, Findings of Fact or Conclusions of Law. We will not repeat all of the facts stated above. It seems clear, as a matter of fact, that the District Court did not base its decision on Section 44 of the 1939 Code and therefore the appellant cannot prevail on this "issue."

It is noteworthy that in appellant's argument on this "issue", contained on page 18 to 32, that whereas an extensive legal argument is presented, no facts are stated which would bring those legal arguments into play. Nor does the appellant state any facts about this "issue" in his Statement of the case appearing on page 5 through 13 of his brief.

Since the appellant has stated no facts which would warrant the raising of this "issue" and since the facts contained herein clearly demonstrate that the District Court did not apply Section 44 of the 1939 Code, it is submitted that as to this "issue" the appellant's appeal must fail and the judgments must be affirmed.

2. *The District Court correctly held that no "fatal variance" was involved in these cases.*

Appellant claims the District Court erred in failing to hold that as to the years 1951, 1952, and 1953 as to taxpayer William G. Elliot and as to the years 1950, 1951, 1952, and 1953 as to taxpayer Thomas W. Elliot, that there was a "fatal variance" between the complaints and the refund claims for those years (Appellant's brief, p. 14). On page 16 of his brief, appellant states that the refund claims for the above years were based on the ground that a completed sale occurred in 1946 while both the complaints and the judgments of the District Court were based on the grounds that the sale was taxable pursuant to Section 44 of the 1939 Internal Revenue Code.

It does not seem necessary to discuss all of the material contained on pages 32-36 of appellant's brief because

this "issue", somewhat similar to the preceding "issues", is simply a moot question because the complaints and also the judgments in these cases are *not* based on Section 44 of the 1939 Code. See above at pages 50 to 55 and pages 58-59.

The appellant cannot prevail on this "issue" because he has assumed an incorrect set of facts. That is, neither the complaints nor the District Court's decision are based on Section 44 of the 1939 Code. A full discussion of the legal authorities is therefore unnecessary but the appellees do want to point out that the reason behind requiring a taxpayer to base his complaint on the same grounds as those contained in his refund claim, is to avoid requiring the taxing authorities to investigate the *fact* situation contained in a refund claim and later be faced with a different *fact* situation in dealing with a refund suit which would necessitate a second factual investigation. Hence, the rule prevents a taxpayer from alleging one set of *facts* in a refund claim and then coming along later and suing on a different set of *facts*. It has never been held that a variance in *legal theories* between a refund claim and a complaint is such a "fatal variance" as to preclude a recovery.

The cases cited by the appellant on pages 33 to 36 of his brief, and particularly the decisions of this Court which are listed therein, clearly state that in order for the "fatal variance" doctrine to be applicable there must be a fatal variance between the *facts* alleged in the refund claim and the *facts* alleged in a taxpayer's complaint.

This is also the rule enunciated in *United States v. Andrews,* 302 U. S. 517, wherein the Supreme Court held an "amended" claim was invalid where it contained a different *factual* grounds for recovery. However, the Supreme Court indicated that an amended claim based on the same facts, but utilizing a different legal theory or grounds, was a valid amendment.

In *Warner v. Walsh,* 24 F. 2d 449 (D. C. Conn. 1927), the Commissioner of Internal Revenue contended that the lagal theory relied on by the taxpayer was not set forth in the refund claim and therefore the taxpayer should be barred from recovering a tax overpayment. The Court said that the Commissioner was apprised of all of the material facts which were contained in the refund claim and the Court further stated:

> "It is true that the *theory* of the relief is not set out. But the *theory* of a claim for relief is something separate and apart from the facts, and the same set of facts may, and often does, give rise to differing theories. To say that an argument may not be advanced in this court which was not elaborated in notice of claim before the Commissioner is unwarranted by the language and intent of the statute under consideration."

In *Wunderle v. McCaughn,* 38 F. 2d 258 (D. C. Pa. 1929), the *facts* contained in the refund claim were the same as those alleged in the complaint and presented at the trial. However, in the refund claim, a legal theory was set forth to the effect that a deduction was allowable because a bad debt had been incurred, whereas, the taxpayer later argued that the deduction was in the nature of additional compensation rather than a bad debt. The

Court held that a claim for refund which sets forth all of the facts giving rise to a claim is sufficient compliance with the statute, and, further, the fact that an erroneous legal theory is presented does not destroy the legal sufficiency of the claim for refund. The Court further said that where the Commissioner of Internal Revenue is apprised of all of the material facts, it is immaterial that the theory on which relief is asked is not set out nor is it material that a wrong theory is set forth in the refund claim.

It is submitted that all of the refund claims filed in these cases are based on the same basic *facts,* that is, that the "Lease Agreement and Purchase Option" and the "Memorandum Agreement" constitute a sales agreement rather than a true lease. Only one investigation by the Internal Revenue Service was required and that investigation concerned whether or not the agreements constituted a sales agreement or a true lease agreement. It is granted that the refund claims for the earlier years, which were prepared by the taxpayers' accountant, did contain the *legal theory* that the gain on the sale should be computed and taxed pursuant to Section 44 of the 1939 Code. The latter refund claims abandoned this *legal theory* but the same basic facts were alleged therein and also in the complaints.

In the Prayer of both complaints, (paragraph (36) of No. 15983 and Paragraph (38) of No. 15984), certain figures are set forth which are based on the theory that a completed sale occurred in 1946 and no reference is

made to Section 44. The amounts prayed for relating to the refund claims for the latter years are not connected in any way to Section 44. It is true that for some of the earlier years the amounts demanded are the same or similar to the amounts asked for in the refund claims wherein Section 44 was erroneously referred to and applied by the accountant who prepared those refund claims. However, the reason for the similarity of the amounts is not due to any contentions by the appellees that Section 44 is applicable but rather to the general rule that a taxpayer cannot sue for a refund in a greater amount than that demanded in his refund claim. It is the general practice today for the refund claim draftsman to insert, after a demand for a certain amount of dollars, the words "or such greater amount as is legally refundable". In such case, a larger amount can be asked for in the prayer in a complaint. *Woolworth & Co., v. U. S.*, 91 F. 2d 973. However, no qualifying words were added after the specific dollar amounts requested by the taxpayers herein and therefore in the complaints only the dollar amounts asked for in the refund claims were demanded.

It is further submitted that the amounts asked for in the Prayer to the complaints do not, in themselves, give rise to any particular substantive legal theory of law nor should they be considered out of context with all of the other allegations contained in the complaints. The amounts asked for in the Prayer depend upon many factors relating to both the merits and procedural aspects of the case and also to many technicalities. In addition,

it is universally recognized that an amount asked for in a prayer to a complaint does not constitute a part of the facts giving rise to a cause of action.

It is also noted that the stipulation of amounts deemed to be the correct overpayments in these cases made it unnecessary for the District Court to decide whether or not the full capital gain was taxable in 1946 or whether the taxpayers would first be allowed to recover their adjusted cost basis of the property and thereafter each yearly payment received would be included as a capital gain in their tax returns for the years of receipt.

Since the appellant has stated no facts which would warrant the raising of this "issue" and that in any event no "fatal variance" in involved, it is submitted that as to this "issue" the appellant must fail and the judgments must be affirmed.

CONCLUSION

Under the record in this proceeding, the exhibits, the stipulation agreements between the parties, and the law pertinent to these cases, the judgments must be affirmed. The District Court did not err and certainly no reversible error was committed.

Respectfully submitted,
JACK W. BURNETT
FELT, FELT & BURNETT

By.....
By JACK W. BURNETT
Attorney for Appellees

No. 15987

United States
Court of Appeals
for the Ninth Circuit

ELMER J. FAUL and SYBELL E. FAUL,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif. — 6-03-58

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Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—5-23-58

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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The Tax Court of the United States

Docket No. 56541

ELMER J. FAUL and SYBELL E. FAUL,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioners hereby petition for the redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency dated December 6, 1954 (Symbols: Ap:SF:AA:SMS 90-D:RCS), and to show the jurisdiction of this Court and as the basis for this proceeding, allege as follows:

1. The petitioners are individuals, husband and wife, residing in Carmel, Monterey County, California; their address is P. O. Box 248. Petitioners' joint income tax return for the year 1952 was filed with, and the tax liability disclosed thereon was paid to, the Collector of Internal Revenue, San Francisco, California.

2. The Notice of Deficiency (a copy of which is attached hereto and marked Exhibit "A") was mailed to petitioners on December 6, 1954.

3. The deficiency determined by respondent is in income tax for the calendar year ended December 31, 1952, in the amount of $18,350.23.

4. The determination of the tax set forth in said Notice of Deficiency (Exhibit "A") is based upon the following errors:

(a) Respondent erred in holding that the reported income in the amount of $68,837.96 received by petitioner husband as compensation for personal services rendered during a period of sixty-seven (67) months commencing in February, 1944, and ending in September, 1949, may not be prorated over said 67-month period in the computation of petitioners' tax liability for the year ended December 31, 1952.

(b) Respondent erred in holding that the above amount of $68,837.96 is includable in full in gross income for the year ended December 31, 1952, in accordance with Section 22(a) of the Internal Revenue Code.

(c) Respondent erred in holding that said $68,837.96 was not compensation for personal services covering a period of thirty-six (36) calendar months or more within the meaning of Section 107(a) of the Internal Revenue Code.

5. The facts upon which petitioners rely as a basis for this proceeding, and to sustain the above assignments of error, are as follows:

(a) Petitioner husband was a full-time employee of the R. E. Myers Co. of Salinas, Monterey County, California, from February, 1941, to March, 1946, in the position of Office Manager. The R. E. Myers Co. was, at a time pertinent hereto, a subsidiary of the

Salinas Valley Ice Co. (also referred to as the Salinas Valley Ice Co., Ltd.) of Salinas, Monterey County, California. Petitioner husband was not at any time during his employment in charge of the tax records, preparation of tax returns, nor had he authority in establishing policies to be followed in filing the tax returns for the two above-named companies or either of them. The tax records and the tax returns were prepared for the above-named companies by one Emmett Gottenberg (now deceased) a Certified Public Accountant of San Jose, California. Said Gottenberg made several examinations each year of the books of the above-named companies, and at the end of each taxable year he prepared the tax returns for the two companies. Petitioner husband, at different times, did call said Gottenberg's attention to certain items which were being charged off on the tax returns of said companies as expense, but which he believed to be improper charges; that is, the expenses appeared to him to be the personal expenses of one R. E. Myers (now deceased), one of the owners of said companies. Said Gottenberg disregarded the suggestions so made to him by petitioner husband, and petitioner husband therefore began in February, 1944, to accumulate information and data and documents pertaining to the improper charge-offs, and he compiled, after office hours, a file thereof, which file, by the early part of 1947, showed a very considerable amount representing improper charge-offs by the two companies mentioned. On February 22, 1947, he reported in person to one John J. Boland, Assistant

Chief Field Deputy in respondent's San Francisco office, concerning the tax evasion and fraud perpetrated by either or both of the two above-mentioned companies, and he supported his report with data from the records compiled by him, which records were examined by said Boland. Subsequently, one Jack O'Connell, an agent for respondent, together with other agents visited petitioner husband in his at-that-time home, on 217 Pajaro Street, Salinas, Monterey County, California. Petitioner husband supplied to said agents all information theretofore given by him to said Boland and gave to them additional data in answering a great many questions directed to him by said agents concerning the matter of tax evasion of said two companies. He was visited thereafter by respondent's various agents for the purpose of obtaining additional information, which petitioner husband readily supplied to them. He also visited respondent's office in San Francisco a great many times during the years 1947 through 1950, during which time the data and supporting records supplied by him were checked by respondent's agents.

Petitioners filed a formal claim for reward for information on February 22, 1947, which claim was assigned No. 8990 for record purposes. Respondent's agents continued the checking of the records supplied by petitioner husband, and pertaining to the tax matter of the two above-mentioned companies, at least until April 14, 1950, when petitioner husband was informed by respondent's Washington

office that his claim No. 8990 was not ready for action because a report was awaited from the Field Office to determine if action had been completed on information supplied by him. Petitioner husband continued to answer inquiries and supply additional information to respondent's agents, and he kept himself available as a witness in a possible criminal prosecution until February 18, 1952, on which date he was informed by respondent's Washington office that his claim No. 8990 was allowed by the Assistant Commissioner of Internal Revenue in the sum of $68,837.96.

> "The amount of this allowance is based upon net additional income taxes collected from the taxpayer involved [i.e. Salinas Valley Ice Co., Ltd. and R. E. Myers, deceased] as a result of the information furnished by * * *" petitioner husband.

Subsequently, on March 21, 1952, pursuant to a notice of settlement of claim issued from the General Accounting Office (Certificate No. 2021588, Claim No. Z-962662), it was certified that the sum of $68,837.96 was due petitioner husband from the United States:

> "* * * on account of reward as informer in the case of Salinas Valley Ice Co., Ltd. and R. E. Myers, deceased, First District of California, as approved by the Assistant Commissioner of Internal Revene (Bu. of Int. Rev., Claim No. 8990)."

Said notice also indicated that said sum so due to petitioner husband was payable from appropriation

"2020902.3, Salaries and Expense, Bureau of Internal Revenue, 1952."

Thereafter, in April, 1952, petitioner husband received from the Comptroller General of the United States, a Treasury Check in the amount of $68,-837.96, in settlement of said claim.

(b) Petitioners filed their joint tax return for the calendar year 1952 in which they included in their gross income the said sum of $68,837.96 as received from the Budget and Finance Division of the Bureau of Internal Revenue, Washington 25, D. C., together with Form 1099 supplied by said Division showing that said sum was received by petitioner husband for "salaries, fees, commissions, or other compensation." Attached to the said return was a statement setting forth that:

> "In April of 1952, Mr. Elmer J. Faul [petitioner husband] received $68,837.96, the entire compensation for performance of personal service, covering a period of 67 months, commencing services in February, 1944, to completion of services in September, 1949. The taxpayer reports income on the cash basis. Separate returns on a community basis with wife, Sybell E. Faul [petitioner wife] have been filed for years 1944 to 1947, incl.—joint returns have been filed for the years 1948 to present. The attached Exhibit A and supporting schedules present an allocation of income to years of services rendered in accordance with Sec. 107(a) of the Internal Revenue Code."

Said Exhibit "A" showing allocation of Sec. 107 "Income," showed that each of the petitioners received in the year 1944 11/67th of the said amount of $68,837.96, or $5,650.87 each; and that for the years of 1945 to 1948, inclusive, they received 12/67th for each year, or $6,164.60 each; for the year 1949 each of the petitioners received 8/67th of said amount of $4,109.73 each for a total received by petitioner husband of $34,419.00 and by petitioner wife of $34,418.96 (corrected as to pennies).

On the basis of the above allocation and as shown in Schedule 5 attached to said joint income tax return of petitioners, $17,065.78 was payable by petitioners on said $68,837.96, Sec. 107 "Income." This tax so calculated and due from petitioners was paid by them to respondent together with taxes due on other income received by them during the year 1952.

(c) Although petitioner husband performed services for and held himself available to respondent in connection with supplying information with reference to the tax matters of the two above-mentioned companies from February, 1944 until 1950 and required additional effort until February, 1952 to obtain payment of his claim, since the bulk of work on petitioner husband's part was completed by September, 1949, therefore petitioners allocated said income under Sec. 107(a) of the Internal Revenue Code to cover a period of 67 months, from February, 1944 to September, 1949.

(d) Respondent's agent, examining petitioners' 1952 income tax return, advised them that after con-

sulting with his supervisor, he could find no precedent for application of Sec. 107 to this type of compensation, and therefore respondent held that the benefits of Sec. 107 of the Internal Revenue Code are denied in computation of the tax liability of petitioners with reference to the lump sum of $68,837.96 received by them in the year 1952 for services rendered as set forth above and over the period of years indicated. The examining agent computed petitioners' tax liability based upon Sec. 11 and Sec. 12 of the Internal Revenue Code, disclosing a deficiency of $18,350.23.

(e) Petitioners filed their protest to such holding and finding on September 20, 1952, with the District Director of Internal Revenue, Audit Division, San Francisco 2, California, setting forth the facts and claiming on the basis thereof and on the basis of pertinent law that Sec. 107 of the Internal Revenue Code permits the application thereof to the computation of the tax liability on said lump sum award of $68,837.96.

(f) Respondent determined that said sum received by petitioner husband as compensation for personal services was not compensation for personal services covering a period of 36 months or more within the meaning of Section 107(a) of the Internal Revenue Code, and further determined that the said amount of $68,837.96 is includable in full in gross income for the year ended December 31, 1952, in accordance with Sec. 22(a) of the Internal Revenue Code; and without the interposition of this Court, the total tax liability from such erroneous

determination by respondent would be assessed against petitioners and collection thereof demanded from or enforced against them. Such determination by respondent is on its face erroneous and void.

Wherefore, petitioners pray that this Court may hear this proceeding and determine the correct income tax liability for the calendar year 1952.

FRANCIS HEISLER,

PEARL BAER,

Counsel for Petitioners.

Duly verified.

Copy

Form 1230 (App.)

EXHIBIT "A"

U.S. Treasury Department
Internal Revenue Service
Regional Commissioner
Appellate Division—San Francisco Region
Room 1010—870 Market Street
San Francisco 2, California

December 6, 1954

In Replying Refer to
Ap:SF:AA:SMS
90-D:RCS

Mr. Elmer J. Faul and
Mrs. Sybell E. Faul
P.O. Box 248
Carmel, California

Dear Mr. and Mrs. Faul:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1952, discloses a deficiency or deficiencies of $18,350.23 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D.C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, Room 1010, 870 Market St., San Francisco 2. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt

of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner;

By /s/ WM. G. WILKER,
Special Assistant,
Appellate Division.

Enclosures:
Statement
Form 1276
Agreement Form

Statement

Ap:SF:AA:SMS
90-D:RCS

Elmer J. Faul and
Sybell E. Faul
P.O. Box 248
Carmel, California

Tax Liability for the Taxable Year Ended December 31, 1952.

Year		Deficiency
1952	Income Tax	$18,350.23

In making this determination of your income tax liability, careful consideration has been given to your protest dated September 20, 1954, and to the statements made at the conferences held on October 29 and November 15, 1954.

A copy of this letter and statement has been mailed to our representative, Mathew M. Maguire, Room 303, Professional Building, 215 Franklin Street, Monterey, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Income

Year: 1952

Net income as disclosed by return.....	$70,243.66
Net income as adjusted.....	$70,243.66

Explanation of Adjustments

In your return for the year ended December 31, 1952, you reported income in the amount of $68,837.96 as compensation for personal services covering a period of 67 months, commencing in February, 1944, and ending in September, 1949, and prorated the income over the 67 month period in the computation of your tax liability for the year ended December 31, 1952.

It is held that the amount shown above is includable in full in gross income for the year ended December 31, 1952, in accordance with Section 22(a) of the Internal Revenue Code and that such income was not compensation for personal services covering a period of thirty-six calendar months or more within the meaning of Section 107(a) of the Internal Revenue Code.

Computation of Income Tax—Individual

Year: 1952

Net adjusted income	$70,243.66	
Exemptions: 2 @ 600.00 each.....	1,200.00	
Income subject to tax	$69,043.66	
One-half of taxable income (If joint return)	$34,521.83	
Income tax		$17,730.84
Income tax (Double the above—if joint return)		$35,461.68

Self-employment tax (from return or as corrected)	38.57
Total tax liability	$35,500.25
Income tax liability disclosed by original return, A/C #AR 700303, 1st Calif. District	17,150.02
Deficiency in income tax	$18,350.23

Served March 1, 1955.

Received and filed February 28, 1955, T.C.U.S.

[Title of Tax Court and Cause.]

REQUEST FOR DESIGNATION OF PLACE OF HEARING

Comes now Elmer J. Faul and Sybell E. Faul, by their attorneys, Francis Heisler and Pearl Baer, and in accordance with Rule 26 of the Rules of Practice Before the Tax Court of the United States,

Requests that the Court designate that the hearing in the above-entitled proceeding be held at San Francisco, California, or vicinity, in order to afford the respective parties an opportunity to produce evidence at the trial with a minimum expense.

/s/ FRANCIS HEISLER,

/s/ PEARL BAER,

Attorneys for Petitioners.

Received and Filed February 28, 1955, T.C.U.S.

Granted March 4, 1955.

Served March 7, 1955.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service, and for answer to the petition filed by the above-named petitioners, admits and denies as follows:

1. Admits that the petitioners are individuals, husband and wife, residing in Carmel, Monterey County, California; admits that their address is P.O. Box 248; admits that petitioners' joint income tax return for the year 1952 was filed with the Collector of Internal Revenue, San Francisco, California; denies the remaining allegations contained in paragraph 1 of the petition.

2. and 3. Admits the allegations contained in paragraphs 2 and 3.

4. Denies the allegations of error contained in paragraph 4 and in each and every subparagraph thereunder.

5. (a). Admits that petitioner husband was a full-time employee of the R. E. Myers Company of Salinas, Monterey County, California, from February, 1941 to March, 1946, in the position of Office Manager; admits that the R. E. Myers Company was, at a time pertinent hereto, a subsidiary of the Salinas Valley Ice Company of Salinas, Monterey County, California; admits that petitioner husband

received a Treasury Check in the amount of $68,-837.96; denies the remaining allegations in subparagraph (a) of paragraph 5.

5. (b). Admits that petitioners filed their joint tax return for the calendar year 1952, in which they included in their gross income the said sum of $68,837.96; admits that attached to the said return was a statement; denies the remaining allegations in subparagraph (b) of paragraph 5.

(c). For lack of information, denies the allegations in subparagraph (c) of paragraph 5.

(d). Admits that respondent held that the benefits of Sec. 107 of the Internal Revenue Code are denied in computation of the tax liability of petitioners with reference to the lump sum of $68,837.96 received by them in the year 1952; denies the remaining allegations in subparagraph (d) of paragraph 5.

(e). Admits the allegations in subparagraph (e) of paragraph 5 of the petition, except denies that the protest was filed on September 20, 1952.

(f). Admits that respondent determined that said sum received by petitioner husband as compensation for personal services was not compensation for personal services covering a period of 36 months or more within the meaning of Section 107(a) of the Internal Revenue Code, and further determined that the said amount of $68,837.96 is includable in full in gross income for the year ended December 31, 1952, in accordance with Sec. 22(a) of

the Internal Revenue Code; denies the remaining allegations in subparagraph (f) of paragraph 5.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination in all respects be approved and the petitioners' appeal denied.

/s/ R. P. HERTZOG,
Acting Chief Counsel,
Internal Revenue Service.

Filed April 19, 1955, T.C.U.S.

Tax Court of the United States
Washington

Docket No. 56541

April 10, 1957

ELMER J. FAUL, Et Al.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Trial on: June 17, 1957

Trial at: Customs Courtroom
U.S. Appraisers Bldg.
630 Sansome Street
San Francisco, Calif.

To: Francis Heisler, Esq.
P.O. Box 3426
Carmel, California

NOTICE OF SETTING PROCEEDING FOR TRIAL

Take Notice that the above-entitled proceeding is included on a calendar of cases set for trial before a Division of the Tax Court of the United States as indicated above.

That calendar will be called at 10.00 a.m. on the date indicated above and you will be expected to answer the call at that time and be prepared for trial when the above-entitled proceeding is reached. Continuance will be granted only for extraordinary cause. Failure to appear will be taken as cause for dismissal in accordance with Rule 27(b)(3) of the Court's Rules of Practice.

You are expected to be familiar with the Court's Rules of Practice in all other respects.

Your attention is called particularly to Rule 31(b) which requires that the parties stipulate facts and evidence to the fullest possible extent prior to the call of the calendar. You should confer with your adversary promptly in order to comply with that rule.

Respectfully,

/s/ HOWARD P. LOCKE,
Clerk.

Served: April 10, 1957.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is stipulated by and between the parties hereto, by their respective counsel, that the following facts shall be taken to be true in the above-entitled case and received as evidence therein, subject to the right of either party to offer such further and additional evidence not inconsistent with or contrary to the matter herein stipulated:

1. The petitioners are formerly husband and wife who were divorced after the filing of the petition in this case; that the interlocutory decree of divorce was entered in the Superior Court of the State of California in and for the County of San Francisco in Cause No. 449942 and entitled Elmer J. Faul, Plaintiff v. Sybell E. Paul, Defendant. Said decree was filed on the 29th day of December, 1955; a final decree of divorce was entered subsequently; and that petitioner Sybell E. Faul resides in Carmel, Monterey County, California, and that the other petitioner Elmer J. Faul resides in San Francisco, California.

2. Petitioners filed their joint income tax return for the year 1952 with the District Director of Internal Revenue, San Francisco, California.

3. Petitioner Elmer J. Faul was a full time employee of the R. E. Myers Company of Salinas, Monterey County, California, from approximately February, 1941, to March, 1946. The R. E. Myers

Company was a subsidiary of the Salinas Valley Ice Co. (also known as Salinas Ice Co., Ltd.) of Salinas, Monterey County, California.

The tax records were kept and the tax returns for the above-named companies were prepared by one Emmett Gottenberg, a certified public accountant of San Jose, California.

4. On February 22, 1947, petitioner Elmer J. Faul had an interview in San Francisco with John Boland, Chief Field Deputy in the office of the Collector of Internal Revenue, San Francisco, California. At that time petitioner Elmer J. Faul submitted to Boland a memorandum of alleged violations of Internal Revenue laws by the Salinas Valley Ice Company.

5. On the same day, February 22, 1947, Elmer J. Faul filed Form 211 as Claim No. 8990.

6. Beginning with the month of March, 1947, petitioner Elmer J. Faul was interviewed by Agent Allan Shurlock and other agents to whom he gave the above-mentioned memoranda.

7. Petitioner Elmer J. Faul subsequently supplied additional information and answered queries directed to him pertaining to the above companies by Revenue Agent Shurlock.

8. Petitioner Elmer J. Faul also corresponded in writing with officials of the Internal Revenue Service and the Treasury Department.

9. In April, 1952, petitioner Elmer J. Faul received a check in the amount of $68,837.96 as informer's award.

10. The Collection Office of the Internal Revenue Service in Salinas, California, demanded an estimated tax return and the payment of estimated tax with respect to the receipt by petitioner Elmer J. Faul of the award of $68,837.96. Payment of tax pursuant to such estimated tax return was made by petitioners in the amount of $25,825.82.

Thereafter petitioners filed their income tax return for the year 1952 and in connection with the payment of said $68,837.96 they claimed the benefit of Section 107 Internal Revenue Code of 1939. Accordingly, the return indicated a tax liability of $17,150.02 and an overpayment of $8,825.46, which overpayment was refunded by the Internal Revenue Service to petitioners.

11. Thereupon, respondent determined that said sum of $68,837.96 received by petitioner Elmer J. Faul "was not compensation for personal services covering a period of thirty-six (36) calendar months or more within the meaning of Section 107(a) of the Internal Revenue Code * * *" and further determined that "the said amount of $68,837.96 is includable in full in gross income for the year ended December 31, 1952, in accordance with Section 22(a) of the Internal Revenue Code * * *" The examining agent computed petitioners' tax liability based upon Section 11 and Section 12 of the Internal Revenue

Code on the basis of which a deficiency of $18,-350.23 was claimed.

/s/ FRANCIS HEISLER,
Counsel for Petitioners.

/s/ NELSON P. ROSE,
Chief Counsel, Internal Revenue Service, Counsel for Respondent.

Filed at Trial June 24, 1957 T.C.U.S.

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29 T. C. No. 49

Tax Court of the United States

Docket No. 56541

ELMER J. FAUL and SYBELL E. FAUL,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

FINDINGS OF FACT AND OPINION

An informer's award of $68,837.96 did not qualify for treatment under Section 107(a), Internal Revenue Code of 1939, since services leading to award did not extend over a 36-month period.

Francis Heisler, Esq., for the petitioners.

Edward H. Boyle, Esq., for the respondent.

Respondent determined a deficiency of $18,350.23 in petitioners' joint return for the taxable year 1952.

The only question presented is whether an informer's award received by petitioner Elmer J. Faul qualifies for treatment under Section 107(a), Internal Revenue Code of 1939.

Findings of Fact

Some of the facts were stipulated and are incorporated herein by this reference.

Petitioners, Elmer J. Faul and Sybell E. Faul, formerly husband and wife, were divorced after the filing of the petition in this case. Elmer J. Faul (hereinafter sometimes referred to as Faul) now resides in San Francisco, California. Sybell E. Faul (hereinafter sometimes referred to as Sybell) resides in Carmel, California. Petitioners filed their joint income tax return for the year 1952 with the district director of internal revenue, San Francisco, California.

From approximately February 1941 to March 1946 Faul was employed full time as office manager by the R. E. Myers Company, of Salinas, Monterey County, California. The R. E. Myers Company was a subsidiary of the Salinas Valley Ice Company (also known as Salinas Ice Company, Ltd.), of Salinas, Monterey County, California.

Following 1942 Faul asked his employer, Ralph Myers, why he was cheating with his books and exposing himself to a charge of fraud. Faul further stated that he did not wish to remain with Myers and continue to be exposed to such conduct. Myers regarded the objections lightly and assured Faul that he would "have someone else do it." At that time he hired Emmett Gottenburg, a certified public accountant. Gottenburg kept the tax records and prepared the tax returns for the above-named companies.

In 1944 Faul went to San Francisco to talk to "some Government man" about what he should do to protect himself. He was told that he should make records and have evidence so that he would not be exposed.

In order to shield himself, Faul, working in his home and in the office late at night, commenced to compile records in February or March of 1944. He continued with this record making for the remainder of 1944 and during 1945 and part of 1946.

Faul was discharged by the Myers Company in March 1946. Thereafter he determined to submit evidence of the alleged fraud to the Government, and on February 22, 1947, he had an interview in San Francisco with John Boland, Chief Field Deputy in the office of the collector of internal revenue, San Francisco, California. At that time he submitted to Boland a memorandum of 45 alleged violations of internal revenue laws by the Salinas Valley Ice Company. On the same day Faul filed

a claim for reward on a form 211. Additional information supplied by Faul between April and July of 1947 increased the allegations to a total of about 68 or 70.

Alan Russell Shurlock (hereinafter referred to as Shurlock), an internal revenue agent, commenced an audit of the Salinas Valley Ice Company in May 1947. He was in contact with Faul concerning the list of allegations during the summer and fall of 1947. The last discussion between Shurlock and Faul for the purpose of enabling Shurlock to understand the allegations took place in September, October and November 1947. He submitted his final report on the Salinas Valley Ice Company in July 1948. The case was then forwarded to the conference section in San Francisco. Shurlock discussed the case with the conferee a number of times. To the best of Shurlock's knowledge, Faul never met nor had a conference with the conferee.

Shurlock, requested by his superiors to assess the value of the information furnished by Faul, reported that "the information furnished by the informer was of good value in the investigation." In so doing he had in mind only the 68 allegations. He never received from Faul any documentary evidence, further studies, or copies of other documents made by him of the books and records of the Salinas Valley Ice Company or the R. E. Meyers Company.

Shurlock saw Faul during 1948 and 1949, usually at Faul's home. Mrs. Shurlock sometimes accom-

panied him. When Mrs. Shurlock came they did not all sit together; she played the piano and Shurlock stayed with Faul, not always in the same room.

Conversations between Faul and Shurlock were limited to the Government case. The general tenor of these conversations was "When am I going to get my reward?" Often they would reminisce about some of the issues involved in which Faul had furnished information, and go over the points that had been brought out. On these occasions, Faul furnished Shurlock no additional information in connection with the case.

Shurlock visited Faul at least once during 1950 and 1951. Sybell was present during such a visit when a conversation concerning the fraud penalties against the Myers Company took place. She could not recall whether Shurlock at that time asked Faul to supply any additional information.

In May 1950 Boland called Faul to San Francisco. Sybell accompanied Faul to Boland's apartment. When asked on direct examination if Boland requested any additional information from Faul, Sybell replied: "Well, yes; my husband went into the kitchen * * * and really nothing much took place, because they were talking in the kitchen for a short time and then they came out and we left." Sybell and Faul never saw Boland except in connection with the case.

During 1950 and 1951 Faul corresponded with officials of the Bureau of Internal Revenue and the

Treasury Department concerning his claim for reward. In one such letter Faul stated: "Mr. O'Connell as his local representative Alan Shurlock conferred with me numerous times during first 2 years after I reported this case for information" [sic].

On September 10, 1951, William W. Parsons, Administrative Assistant Secretary of the Treasury Department, wrote Faul informing him that "it has been found necessary to request additional information from the field office in California and your case can not be concluded until that information is received at headquarters."

In April 1952 Faul received a check in the amount of $68,837.96 as an informer's award. The award was paid from the appropriation for salaries and expenses, Bureau of Internal Revenue.

The collection office of the Bureau of Internal Revenue demanded an estimated tax return and payment of estimated tax with respect to the $68,837.96. Payment of tax pursuant to such estimated tax return was made by the petitioners in the amount of $25,825.82.

Thereafter petitioners filed their income tax return for the year 1952, and, in connection with the payment of the award, claimed the benefit of section 107, Internal Revenue Code of 1939. Accordingly, the return indicated a tax liability of $17,150.02 and an overpayment of $8,825.46. This overpayment was refunded by the Bureau of Internal Revenue. Thereafter respondent determined that

the award received by Faul "was not compensation for personal services covering a period of thirty-six (36) calendar months or more within the meaning of section 107(a) of the Internal Revenue Code," and further determined that the award was includible in full in gross income for the year ended December 31, 1952, in accordance with section 22(a) of the Internal Revenue Code. The examining agent computed petitioners' tax liability based upon section 11 and section 12 of the Internal Revenue Code. On the basis of this computation a deficiency of $18,350.23 was determined.

Opinion

Van Fossan, Judge: The sole question presented here is whether an informer's award received by petitioner Elmer J. Faul may be allocated ratably over a period of three years or more as compensation for personal services under the provisions of section 107(a), Internal Revenue Code of 1939.[1]

---

[1]Sec. 107. Compensation for Services Rendered for a Period of Thirty-Six Months or More and Back Pay.

(a) Personal Services.—If at least 80 per centum of the total compensation for personal services covering a period of thirty-six calendar months or more (from the beginning to the completion of such services) is received or accrued in one taxable year by an individual or a partnership, the tax attributable to any part thereof which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.

For section 107(a) to apply, at least 80 per cent of the total compensation must be received or accrued in one taxable year, the compensation must be for personal services, and the services must cover a period of 36 calendar months or more. The respondent concedes that the first requirement has been met but contends that the two remaining contingencies have not been satisfied.

A taxpayer who claims the benefit of section 107 must show that he comes squarely within the letter and spirit of the Congressional grant. Van Hook v. United States, 204 F. 2d 25 (1953), certiorari denied 346 U. S. 825. We are not persuaded that petitioners have sustained this burden.

Petitioners urge that Faul began performing services for the Bureau of Internal Revenue in 1944.

The record shows that following 1942 Faul became alarmed about the tax practices of his employer. In 1944 he went to San Francisco to talk to "some Government man" for the purpose of determining what he might do to shield himself against possible future charges. Upon his return home Faul followed advice received in San Francisco and commenced to compile records so he would have evidence to protect himself. He continued to make records during 1944, 1945, and 1946. In 1946 Faul was discharged by his employer, and in February, 1947, he submitted a memorandum of alleged violations of internal revenue laws to the office of the collector of internal revenue in San Francisco.

There is no evidence either as to the identity of the "Government man" contacted by Faul in 1944 or that they conferred on any subject other than how Faul might protect himself. The record does not show that Faul identified his employer at this conference.

We conclude that petitioners have not shown Faul to have rendered any service to the Bureau of Internal Revenue before February 22, 1947. Barker v. Shaughnessy, an unreported case (N. D., N. Y., 1954; 48 A.F.T.R. 1301, 55-1 U.S.T.C., par. 9116).

Petitioners argue that even if Faul did not begin to furnish information until February, 1947, nonetheless the statutory period of 36 months may be satisfied. To achieve this they must show that Faul's services continued until February, 1950.

The record establishes that Faul supplied no information subsequent to the fall of 1947. Shurlock, the agent conferring with Faul, filed his report in July, 1948. The case then went to conference. There is nothing to indicate that Faul ever met or had a conference with the conferee. The case was closed in 1950.

Shurlock visited Faul from time to time throughout 1948 and 1949; doubtless they discussed the case at great length. However, their discussion was limited to reminiscence and to when Faul would receive the reward.

Sybell, Faul's wife, was present when a conversation took place between Faul and Shurlock in 1950

or 1951, but could not recall whether Shurlock asked for additional information.

In May, 1951, petitioners paid a visit to John Boland, an official in the collector's office at San Francisco. Sybell testified that Boland requested additional information. However, no evidence was submitted as to what was said, or that Sybell could even hear the conversation, other than that petitioners never saw Boland except in connection with the case. The discussion might well have concerned solely the reward petitioners were striving for. The record does not establish that Faul furnished any such additional information.

On September 10, 1951, William W. Parsons, Administrative Assistant Secretary, Treasury Department, wrote Faul informing him that it had been necessary to request additional information from the field office in California and that Faul's case could not be concluded until that information was received at headquarters. There is no evidence that Faul supplied any of this additional information or that, indeed, Parsons expected to obtain such information from any source other than the field office itself.

Herbert Stein, 14 T.C. 494 (1950), cited by petitioners, does not support their case. They cite only dicta in Smart v. Commissioner, 152 F. 2d 333 (1945). Other cases relied upon by petitioners may be distinguished on their facts.

Petitioners have not established that Faul performed services for the Bureau of Internal Revenue

over a 36-month period and hence may not claim the benefit of section 107(a).

Decision will be entered for the respondent.

Served December 12, 1957.

Filed December 12, 1957.

Entered December 12, 1957.

The Tax Court of the United States
Washington

Docket No. 56541

ELMER J. FAUL and SYBELL E. FAUL,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed December 12, 1957, it is

Ordered and Decided: That there is a deficiency in income tax of $18,350.23 for the taxable year 1952.

/s/ ERNEST H. VAN FOSSAN,
Judge.

Served December 16, 1957.

Entered December 16, 1957.

The Tax Court of the United States

Docket No. 56541

In the Matter of:

ELMER J. FAUL, et al.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

TRANSCRIPT OF PROCEEDINGS

421 U. S. Appraisers Building,
630 Sansome Street,
San Francisco 11, California.

Monday, June 24, 1956.

The above-entitled matter came on for hearing, pursuant to Calendar Call, at 10:10 o'clock a.m.

Before: The Honorable Ernest H. Van Fossan.

Appearances:

FRANCIS HEISLER,
Post Office Box 3996,
Carmel, California,
On Behalf of the Petitioners.

EDWARD H. BOYLE,
For the Respondent.

The Clerk: Docket 56541, Elmer J. Faul, et al. Proceed Gentlemen.

Mr. Heisler: Francis Heisler for the Petitioners.

Mr. Boyle: Edward H. Boyle for the Respondent.

Mr. Heisler: May I make a short statement, your Honor, about the nature of the case?

The Court: You may state what the issues are.

Mr. Heisler: One of the Petitioners, Elmer J. Faul, was employed from about 1941 until March 1, 1946, as a bureau chief by the R. E. Myers Co. in Salinas, California. This company was a subsidiary of the Salinas Ice Company, which was also known as Salinas Ice Company, Limited. Shortly after he began working, as our evidence is going to disclose, he noticed that there were certain irregular entries made by the company which appeared to him were made for the purpose of evading taxes. In 1942 and 1943 and up to 1944, he spoke to his boss, who was Mr. Ralph Myers, that these entries were not proper and that the company will get in trouble unless a change be made. The employer informed him that he, Mr. Faul, has nothing to do with the books pertaining to the taxes, that that job is done by someone else, and that he should keep his nose out of their affairs. Mr. Faul informed his employer that since he, Faul, was pretty much in charge of the office, he will have to protect himself because it will be impossible [3*] for him to convince the Government that he was not a participant in crime in this affair. Mr. Myers informed him again that he should

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

not worry about this matter. However, he did worry about it and, therefore, as our evidence discloses, in 1944, he went to San Francisco and he talked to the Department of Internal Revenue. He stated that there are, in his opinion, certain fraudulent entries made by the company and he doesn't want to have anything to do with the case, he wants to protect himself, and he asked what he is to do. He was advised that he should keep the records, that he should make copies of documents, such documents as he considered fraudulent, and he was also told at that time that if the information that he is to supply should disclose delinquent taxes, he may receive a reward. However, at that time, as our evidence shows, the main problem Mr. Faul had before him is his question of participating in the fraud.

From 1944 to 1946, he repeatedly called upon his employer, who was also a friend of his, that he should stop making these improper charges because the company was making plenty of money, there was no need to try to make some more money by cheating the Government, but he was refused any proper answer. In fact, in February 1946, Mr. Ralph Myers, the employer, fired him from his job, and he told Mrs. Faul that he is very sorry that he had to fire him, but he was getting into the hair of the company and they had to eliminate [4] him from a place where he could have access to the records, and as of March 1, 1946, he had no more access to the books, though he had by that time accumulated a great deal of information. After he was fired, Mr.

Ralph Myers felt that he owed this man something and he gave half-partnership to his wife in Tassajara, which is a hotel up in Carmel Valley. Mrs. Faul was managing the place from April 1946 until late that year when Ralph Myers, the owner of the company, or one of the owners of the company, was killed in an accident. The father, Senior Myers, came down to the hotel and told the Fauls they would have to get out of the place. When they insisted they were given half-partnership in the place, which they were earning, the man threatened them with dire consequences. As a matter of fact, he insisted of Mr. Faul, if he did not give up the Tassajara, he was going to ruin him. Mr. Faul was very disturbed, in discussing this with his wife, was afraid that Mr. Myers would go to the Income Tax Department and that all the fraudulent entries would be disclosed as having been made by Mr. Faul. The two of them then decided they were going to turn over the records to the Income Tax Department, as Mr. Faul had been collecting them for years. Our evidence is going to disclose, Your Honor, that Mr. Faul made the copies after working hours, either at his home where he took the books, or in his office, but always after working hours.

In February, early in February 1947, in [5] accordance with an understanding between Mr. and Mrs. Faul, Mr. Faul wrote a letter to the Income Tax Department and stated that he had enough records to prove that the Myers Company was guilty of fraud. He was then asked to come to San

Francisco, where he talked to Mr. John Boland, who was the Chief Field Officer, if I remember correctly his title, and turned over to him a summary of the information that he had collected from 1944 on. At that time Mr. Boland suggested to him that he should fill out a Form 41, which he did. That is dated February 22nd.

Beginning with late February or early March 1947, Mr. Faul and Mrs. Faul were visited in their home in Salinas by numerous agents, among them Mr. Jack O'Connell——

The Court: Agents of what?

Mr. Heisler: He was an agent of the Income Tax Department, he was the agent in charge, or field agent.

The Court: Internal Revenue Agent?

Mr. Heisler: Internal Revenue Agent, yes.

Mr. O'Connell came down to talk to Mr. Faul, to determine whether or not this summary of information could be substantiated by Mr. Faul's own statement. After Mr. O'Connell obtained that information, he assigned some other agents, one of them being a Mr. Shurlock, and another was a Mr. Van Schroeder. These agents were coming to Mr. Faul's place during the years of '47, '48 and '49. During that time Mr. Faul was always willing, ready and able to supply additional [6] information, which information finally culminated in a deficiency assessment against the Myers Company in March 1950, according to which almost $1 million additional taxes were recovered.

The testimony will show that the man in charge

of the conference on these deficient taxes of the Myers Company recommended a fraud penalty of about $500,000.00. However, the agent, I believe it was Mr. Shurlock, recommended against the assessment of these fraud charges, and he came back, in accordance with the instructions received from Washington, to Mr. Faul to obtain additional information during the year of 1950 and in 1951. Mr. Shurlock and Mr. Faul had a great many discussions at Mr. Faul's home during which Mr. Faul was attempting to show that there was evidence to obtain these additional fraud penalties. However, the report was sent in finally and in consequence of such report no fraud penalty was assessed.

The Court: It is not necessary to go into such detail, Mr. Heisler.

Mr. Heisler: Early in 1952, Mr. Faul received from the Government the sum of 68 thousand and some-odd dollars as his reward. Immediately thereafter the Internal Revenue Department collected from him some 28 thousand dollars taxes and then he filed his 1952 joint return, claiming that his services were rendered over a period of 67 months and that in consequence he is entitled to the benefits of Section 107(a). [7] On preliminary investigation this claim was upheld and he received back about $8,000.00.

Subsequently, however, the Government claimed that these services were not extending over 36 months or longer and assessed against him additional taxes of $18,350.00.

We are contending that the taxpayers are entitled to the benefit of Section 107(a). That is our case, Your Honor.

The Court: Mr. Boyle?

Mr. Boyle: The first indication in the Government's files of Mr. Faul's activity was on February 22, 1947, at which time he came to San Francisco and discussed the case briefly with Mr. Boland, and he left with Mr. Boland a list of allegations of charges that the Salinas Valley Ice Company had not been paying their full tax. At that time he filled out a Form 211 for an informer's award. The case was assigned to a Revenue Agent in April of 1947, and he got in touch with Mr. Faul for further explanation of the list of allegations. He turned in his report in July of 1948. That was the termination of the Revenue Agent's investigation of the Salinas Valley Ice Company, the corporation on which Mr. Faul had informed.

The case then went to conference in San Francisco—I may say that the Salinas Valley Ice Company, Mr. Faul and Mr. Shurlock, the Revenue Agent, were all in the vicinity of either Salinas, Carmel or Monterey——the case came to San Francisco for conference and, although Mr. [8] Shurlock met with Mr. Faul on a number of occasions in Mr. Faul's home on a social plane, there was no further discussion of the case other than reminiscence and talk about how the officers of the corporation had defrauded the Government and so forth, but all the official work was over. The only thing that occurred after 1948, so far as Mr. Faul was concerned,

was that in 1950 he started writing many letters to the Internal Revenue Service inquiring about his reward, which finally came in about April of 1952. At that time he requested to be paid in several instalments covering several years, and he was told that could not be done, and he was paid in one lump sum of approximately $68,000.00, which, on his return, he spread over a period from, under Section 107, from sometime in 1944 until sometime in 1949.

The Respondent takes the position that the full reward is income in the year received, 1952, on two grounds:

First, it was not compensation for personal services, that Mr. Faul was not an employee in any sense, he was not rendering services, but he actually sold information. There was no contract, no meeting of the minds, there could have been no forcing the reward if Mr. Faul had not received it, it was purely discretionary with the Commissioner, and therefore it was merely the payment for information.

Secondly, it is the position of the Respondent that, in any event, what Mr. Faul did did not cover the period of 36 [9] months or more.

The Court: You may proceed with the evidence.

Mr. Heisler: If Your Honor please, I would like to state for the record that I will have evidence on that score, that Mr. Faul is physically unable to be present, and I would like to call his son so that in a few words he can tell Your Honor why his father could not be present here, and then Mrs. Faul is going to take the witness stand to testify.

The Court: Very well.

Whereupon

GENE FAUL

was called as a witness on behalf of the Petitioners and having been first duly sworn, testified as follows:

The Clerk: State your name, please.

The Witness: Gene Faul.

Direct Examination

By Mr. Heisler:

Q. Where do you live, Mr. Faul?

A. In Carmel, California.

Q. You are the son of Elmer J. Faul and Sybelle E. Faul? A. Yes, sir.

Q. You met your father recently?

A. I saw my father recently, I will say last year, I remember on one occasion. [10]

Q. Do you know his physical and mental condition?

A. Yes, sir. If I may elaborate. Going way back to 1945, my father suffered a nervous breakdown during my high school years, when I noted that he was extremely nervous, and by the time I had entered the University of Santa Clara he was more nervous than ever, and, as I say, last year, with his divorce from my mother, he came down to the Carmel dwelling that they shared and wanted certain belongings and was in a highly excitable state and just appeared so nervous that he was almost

(Testimony of Gene Faul.)

incoherent. I have received numerous letters since that time which clearly indicate to me that he is quite off on a tangent and is not—his nervousness just does not qualify him, I am sure, to testify in this case.

Q. Mr. Faul, at the time when he came down to the house, did you inform the police that you were worried about, that he may do something to your mother, that he is so excited, that he is so disturbed?

A. Yes. We discussed the matter with my mother and we thought that it was a necessary precaution that we do so.

Q. Do you know that in the divorce case your father filed against your mother in San Francisco an injunction was filed against him so that he could not bother your mother? A. Yes, sir.

Mr. Heisler: That is all.

Mr. Boyle: No questions. [11]

The Court: You are excused.

(Witness excused.)

Mr. Heisler: Mrs. Faul.

Whereupon

SYBELLE E. FAUL

was called as a witness on behalf of the Petitioners and having been first duly sworn, testified as follows:

The Clerk: Please state your name.

The Witness: Sybelle E. Faul.

Direct Examination

By Mr. Heisler:

Q. Where do you live, Mrs. Faul?

A. Carmel, California.

Q. You are one of the Petitioners in the case, Docket No. 56541, Elmer J. Faul and Sybelle E. Faul versus the Commissioner of Internal Revenue?

A. Yes, sir.

Q. You are the wife, the former wife of Elmer J. Faul, is that right? A. Yes, sir.

Q. When were you married? A. In 1924.

Q. And you lived together as husband and wife until when? A. Thirty-one years. [12]

Q. And your son mentioned the divorce case. Did you file a divorce suit against him or did he file a suit against you?

A. He filed a suit against me.

Q. And the divorce decree was entered in December, 1955, is that correct? A. Yes, sir.

Q. Where is your husband living now, do you know? A. San Francisco.

(Testimony of Sybelle E. Faul.)

Q. When you saw him the last time, his condition was as your son described, is that correct?

A. Yes, sir.

Q. You don't believe that he would be able to take the witness stand and tell a coherent story?

A. No, sir.

Q. During the time here involved, namely, 1941, when your husband first went to work at R. E. Myers Co., you were living with him as his wife, is that right? A. Yes, sir.

Q. Where were you living at the time when he got the job with the company?

A. Watsonville.

Q. Who was the employer, the immediate employer, of Mr. Faul? A. Mr. Ralph Myers.

Q. In what capacity was Mr. Faul [13] employed by the company? A. Office Manager.

Q. And for a while—By the way, where was he working as an Office Manager?

A. At the Ralph Myers Co.

Q. Where? A. In Salinas.

Q. In consequence, from the beginning of his employment, he had to commute between Watsonville and Salinas, is that correct? A. Yes, sir.

Q. Did you subsequently move to Salinas?

A. Yes. He demanded we move to Salinas because it was during the time——

Q. (Interrupting): Who did that, Mrs. Faul?

A. Mr. Myers. It was during the time we had war with the Japs and the lights were bad, the gasoline situation was very serious, and he insisted

(Testimony of Sybelle E. Faul.)

that he needed him for more time than he was giving him, that he would be working evenings and he would be working very long hours, and he should be in Salinas.

Q. So then you agreed to give up your home in Watsonville? A. And move to Salinas.

Q. And when was that, that you moved to Salinas? A. 1942. [14]

Q. Do you recall following 1942 any conversation between your husband and Ralph Myers concerning any tax irregularities?

A. Yes, I do, because Mr. Myers was in our home a great deal, he wasn't only his employee, we were friends at the time, and my home was very close to the place of business and he used to come in for lunch and he used to drop in late evenings when he felt he didn't want to drive to his ranch. And my husband asked him a couple of times at lunch time why he felt that he had to cheat with his books, because he made enough money without doing it, and it exposed him to fraud, and he didn't want to continue with him, being exposed to such conduct. But Ralph always passed it off lightly and said, "Well, you won't have to do it. I will have someone else do it." And at that time he hired another man to take it over.

Q. Do you know the name of the other man who was hired to do the tax work?

A. His name was—His name has left me.

Q. Was it Emmett Gothenburg?

A. Yes, Emmett Gothenburg, who has now passed away.

(Testimony of Sybelle E. Faul.)

Q. You said that you heard at least two conversations between your husband and Ralph Myers about these tax irregularities. When were those conversations, about?

A. They were in 1942, 1943.

Q. Do you recall any conversation concerning the same matter between your husband and this tax accountant, Mr. [15] Gothenburg?

A. Well, my husband asked Mr. Gothenburg why he did such things as he was doing, and he of course resented it, too, and——

Mr. Boyle: I object. There is no foundation laid for this particular conversation with Mr. Gothenburg.

Mr. Heisler: All right, I will ask some other questions.

By Mr. Heisler:

Q. Was Mr. Gothenburg hired by R. E. Myers Co.? A. Yes, sir.

Q. What was his job, doing what?

A. To—Well——

Mr. Boyle: This has no probative value. I will stipulate that Mr. Gothenburg was an accountant for Salinas Valley Ice. The Myers Company was not a subsidiary, it was just a fictitious name for the farming operations of Salinas Valley Ice Company, but it can be used interchangeably or synonymously with the Salinas Valley Ice Company.

Mr. Heisler: All right.

By Mr. Heisler:

Q. Mrs. Faul, when in 1943 your husband again

(Testimony of Sybelle E. Faul.)

talked to Ralph Myers about the fraudulent tax entries, did you have a conversation with your husband what to do about this matter?

A. I told him I thought he should quit working for him [16] but he felt he was well paid for his job and it was the type of work he liked to do, it was the largest company in Salinas at the time, and a job of his type wasn't easy to get, and he felt, he could continue and maybe some day he would stop Ralph from this.

Q. Did you hear any conversation between your husband and Ralph Myers why your husband was worried about these tax entries, these fraudulent entries?

A. Well, yes, and he always told him it was none of his business, and he wouldn't expose him to anything. But I don't think he wouldn't be exposed to it and wouldn't be accused. In fact, he worried a great deal about it.

Q. All right. Now, do you know what, if anything, Mr. Faul did in 1944 for the purpose of protecting himself against any possible future charge?

A. Well, yes. He came to San Francisco. I didn't come with him, but he came to talk to some Government man, just what he should do to protect himself, and they told him he should make records and have evidence so that he wouldn't be exposed to it himself.

Q. And when was it, about, that he came home

(Testimony of Sybelle E. Faul.)

and started to make records, if he did start to make records, any records?

A. Well, it was February or March.

Q. What year? A. Of '44. [17]

Q. Did you see your husband making those records?

A. Yes, I did. It was at home and at the office during very late hours at night, because his hours were very late. He was never home before midnight.

Q. Did you ever go to the office after office hours?

A. Yes, and he showed me, and I am not terribly smart about books, so it didn't mean a great deal to me.

Q. What did you see, what did he show you?

A. The false entries.

Q. Do you know what he did to keep these records?

A. Well, he made copies and, oh, he was forever at the typewriter and he used to bring them home, he brought the typewriter home, he brought the books home, he did everything to protect himself, and I am sure at the time, at that time, he was only doing it to protect himself.

Q. And he kept this making of records during the year of 1944? A. Yes.

Q. And later on did you see him making these records? A. '45 and '46.

Q. Do you recall February, 1946—Incidentally, before you answer that question, where did Mr.

(Testimony of Sybelle E. Faul.)

Faul keep those records that he made either at his home or at the office?

A. We had an old safe in our house, we bought a very old home in Salinas, and he used to keep them in it. [18]

Q. In February, 1946, do you recall that you had a conversation with Mr. Ralph Myers?

A. Yes, I did.

Q. Where was that?

A. That was in Tassajara, and Mr. Gothenburg was there at the time.

Q. All right. Before that did you have a conversation with Mr. Ralph Myers, before your husband was fired from his job?

A. Well, yes. He called me and told me that he felt my husband shouldn't interfere in his fraud, of the way he kept his books, and that he hired another man to do it, and that he would do anything for me that he could do for me, and would I take Tassajara Hot Springs.

Q. One moment. When was that?

A. In '46.

Q. Was it a personal conversation or over the telephone?

A. Yes, it was over the telephone. I was in Palm Springs.

Q. And Mr. Ralph Myers called you?

A. Yes.

Q. Did he at that time tell you that he fired your husband? A. He told me.

(Testimony of Sybelle E. Faul.)

Q. And your husband stopped being employed by the Myers [19] Company in March, 1946?

A. Yes.

Q. When did your husband stop working for the Myers Company?

A. Well, I think it was March.

Q. What year? A. Of '46.

Q. You testified that Mr. Myers offered you Tassajara? A. Yes.

Q. Will you tell us something more about that?

A. Well, he told me that it wouldn't be a paying proposition for maybe two or three years, he was going to give me a new hotel in Tassajara, but he would give me the bar on the main street that he had bought and that would carry me over with expenses until we had the new hotel in Tassajara Hot Springs.

Q. Did you then move to Tassajara Hot Springs? A. Yes, I did.

Q. Did you take charge of the place?

A. Full charge, yes.

Q. Was your husband at that time in Salinas, or where was he?

A. He was with me in Tassajara.

Q. What was he doing?

A. He assisted with the books and the bar and everything [20] that he could. He was at that time very nervous and high-strung.

Q. When was it that you moved to Tassajara, please? A. In April.

Q. You mentioned that you had a conversation

(Testimony of Sybelle E. Faul.)

with Mr. Gothenburg and Mr. Ralph Myers, or your husband had, in Tassajara. When was that, do you remember?

A. This was in July. The Gothenburgs came in for about a week, and it was at the bar, and I don't know what, how it started, but Mr. Gothenburg and my husband never had a very kind feeling for each other, I think he had been reprimanded by my husband for his false entries and he didn't like it, so he told him he caused him to lose his job, and he said, "Well, it isn't any of your business. You had no business interfering with it at all."

Q. Was Ralph Myers present at the time of that conversation?

A. Yes, but he was quite inebriated. He didn't have anything to do with it.

Q. How long did you remain with your husband at the Tassajara Hot Springs Hotel?

A. From April until August.

Q. What happened in August, 1946?

A. Mr. Myers was killed in an airplane accident and——

Q. That was Ralph Myers? [21]

A. Yes. And he always assured me that none of his family would be allowed to come in and interfere with any part of Tassajara if I took it. He didn't allow his mother, his wife, no one, to come in. And at one time I invited them, and he said, "No, because I think they will interfere. I don't want any interference. You are doing a very fine job. I don't think they should come." But as soon as Ralph

(Testimony of Sybelle E. Faul.)

died, the father, the mother, and everyone came in, and the wife, giving me orders and telling me what to do and that I had to stay until Monday morning and then I could leave, and I assured her that I had been given half of Tassajara Hot Springs, and she said that I had no part of Tassajara Hot Springs and for me to leave immediately, which I did.

Q. Did you hear any conversation between your husband and Mr. Myers, Sr., at that time, before you left Tassajara?

A. Well, he threatened both of us, he was going to break us and, oh, he was a violent man.

Q. After you left Tassajara, where did you go?

A. Salinas.

Q. Did you have any conversation with your husband about the threats that Mr. Myers, Sr., uttered?

A. Well, he was very hurt, and he thought that he should come to the Government and report these false entries, and I thought he shouldn't, and we argued about it a great deal, but as time went on and we found sure that we wouldn't [22] get anything for our services in Tassajara, he decided he would report it. At that time he did.

Q. And when was that that he went to the Government, do you know?

A. I think it was '47 that I went to the Government with him.

Q. What month of the year was that?

A. March or April—March, I believe.

(Testimony of Sybelle E. Faul.)

Q. Well, there is a——

Mr. Heisler: I think there is a copy of the fraudulence form, Form 211, which was filled out on the 22nd of February.

Mr. Boyle: If Your Honor please, this Form 211, the informer's reward form, is not available. We have searched the records here and we had Washington search the records and last week we were in teletype communication with them a number of times and they informed us finally this morning that they had located the Form 211, all of those had been decentralized in '53 and for some reason it had not been sent out here with the file, but they have finally located it. Therefore, if Counsel is agreeable, we can stipulate that the record be kept open for the purpose of putting in evidence the Form 211 when it does finally arrive.

Mr. Heisler: We find, Your Honor, I think there is evidence here showing that that was on March 22nd; as a matter [23] of fact, I think we stipulated——

Mr. Boyle: February 22nd.

Mr. Heisler: February 22, 1947.

Mr. Boyle: That the form was filled out and filed with the Internal Revenue.

The Court: Do you wish to give this an exhibit number?

Mr. Boyle: 1-A. We can attach it to the stipulation of facts which will be introduced, or the file.

The Court: You will supply that within 10 days?

Mr. Boyle: Yes, Your Honor.

(Testimony of Sybelle E. Faul.)

Mr. Heisler: Then, it is agreed that the form was filled out on February 22nd, 1947, so Mr. Faul must have gone before that date to San Francisco.

Mr. Boyle: Yes.

(Petitioner-Respondent Joint Exhibit No. 1-A was reserved.)

PETITIONER-RESPONDENT EXHIBIT NO. 1-A

24-A

Form 211
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
(Revised July 1944)

CLAIM FOR REWARD UNDER TREASURY DECISION NO. 5379

I, Elmer J. Faul. (Name)
217 Pajaro Street Salinas Calif. (Address)
being duly sworn, depose and say that, according to my best information and belief, I furnished to
John J. Boland Asst Chief Field Deputy (Name, title, and address of Bureau officer)
on the 22nd day of Feb., 1947, information which led to the
detection of a violation of the internal revenue laws of the United States by
Ralph E. Meyer Co ✓ (Name), Salinas Calif (Address)
and to the recovery of internal taxes, penalties, fines, and forfeitures; that the information furnished by me was submitted pursuant to the offer of reward made by the Commissioner of Internal Revenue in Treasury Decision No. 5379; and that I was not an officer or employee of the Department of the Treasury at the time I came into possession of the information or at the time I divulged it.

Based upon the foregoing, I now apply for a reward and claim 10 per centum of the amount recovered.

Elmer J. Faul ✓
Claimant.

Sworn to and subscribed before me this 22nd day of Feb., A. D. 1947
John J. Boland Dep. Coll.
(Title)

Form No. 211

BUREAU OF INTERNAL REVENUE

Claim No. 8990

CLAIM OF

Elmer J. Faul

For Reward Offered June 22, 1944

(Treasury Decision No. 5379)

CASE OF

Salinas Valley Ice Co. Ltd. and
Ralph E. Myers, Decd.

First *District of* California

Amount claimed . . 10% . . . . $ _____

Amount allowed 1% to 10% $68,837.96

OFFICE OF
CHIEF COUNSEL

RECEIVED
FEB 21 1952

RECEIVED
G A O
CLAIMS DIVISION
FEB 28 1952

TREASURY DEPARTMENT
OFFICE OF THE
COMMISSIONER OF INTERNAL REVENUE

Washington, D. C.,

FEB 14 1952, 19____

The within claim of _____
Elmer J. Faul _____ is approved and
_____ General Accounting Office, Claims Division, for settlement in
referred to the ~~[illegible]~~ thousand
~~[illegible]~~ the sum of Sixty-eight, eight
hundred thirty-seven and 96/100 _____ dollars,
~~[illegible]~~ 2020902,3 Salaries & Expenses,
~~paid~~ from the appropriation, "~~[illegible]~~
Bureau of Internal Revenue."
~~[illegible]~~
WBT 2-13-52

Fred S. Martin
Assistant *Commissioner.*

OFFICE OF THE SECRETARY OF THE TREASURY,

_____, 19____

Approved for _____

_____ dollars,

and referred to the Comptroller General of the United States.

_____
Secretary.

CLAIMS DIV.
MISC. SECT.

(Testimony of Sybelle E. Faul.)

Q. (By Mr. Heisler): Were you with him at that time?

A. I was with him, yes, sir.

Q. Where did you go with him?

A. I think it was this building, we went to Mr. Boland, and of course he assured us he had to have a great deal more information and that his agents would contact us, and it wasn't too long after that that, I think it was Mr. Van Schroeder and [24] Mr. Shurlock and one other man——

Mr. Van Schroeder, I said—came to our house.

Q. Was it Mr. O'Connell?

A. Yes, Mr. Jack O'Connell came to our house. Well, this seemed to go on for an eternity. I had Government men in my house until I felt it wasn't my house any more, it was an Internal Revenue Bureau. And then my husband became extremely nervous after several years of this, and we moved to Carmel.

Q. When did you move to Carmel?

A. In '48.

Q. During the year of '47 you stated there were Government agents in your house? A. Yes.

Q. They were there for what purpose?

A. Getting information as to Ralph Myers' fraud.

Q. Do you recall anything, any particular questions that were directed to Mr. Faul?

A. Well, they assured him they would never have found any of the fraud or any of the false entries if it hadn't been for his help.

(Testimony of Sybelle E. Faul.)

Q. Who said that, Mrs. Faul?

A. Well, both Mr. Van Schroeder and Mr. Shurlock.

Q. During the year of 1948 were there any Government agents in your house in Salinas in connection with tax information? [25]

A. Yes, sir.

Q. How often would you say in 1948 these agents came to the house?

A. I don't remember how often, but it just seemed it was all the time that they were in my home.

Q. Did you overhear any conversation between your husband and the agents, what these conversations——

A. Well, it was always information they were asking for, and I am sure that he supplied them with plenty of it.

Q. Now, you say in '48 you moved to Carmel?

A. Yes, sir.

Q. And do you recall whether in 1949 any of the Government agents came to your house with reference to information concerning the R. E. Myers Company?

A. I think he only saw Mr. Shurlock in Carmel.

Q. What year was that? A. In '49.

Q. Did you ever hear any conversation between Mr. Shurlock and Mr. Faul?

A. Well, it was always the Government case, that is all I can—that they ever talked about, because we were never intimate friends, I didn't

(Testimony of Sybelle E. Faul.)

know Mr. Shurlock before this Government case came into my life.

Q. Do you recall when you purchased your house in [26] Carmel? A. It was '49.

Q. What month when you moved in there?

A. January.

Q. January of '49. Did Mr. Shurlock come to your house in 1949 to obtain additional information on the Myers case?

A. I think it was information on the Myers case. We were never personal friends, and my husband always met in reference to the Government case when he met with Mr. Shurlock.

Q. Did you ever see your husband and Mr. Shurlock when they closeted themselves in a room, taking out the records and the files that Mr. Faul had collected during the years since '44?

A. No, sir, I didn't. I saw them do it, but I didn't know what they were talking about.

Q. Do you recall in 1949 a conversation with reference to the bookkeeping machine at the R. E. Myers Co. between Mr. Shurlock and Mr. Faul?

A. Well, it seems that when the records were made, the false entries were made, they used the bookkeeping machine and in the evening when the bookkeeper herself was on vacation, and my husband came home to tell me that the whole office was filled with papers, evidently they didn't know how to——

Mr. Boyle: This is all hearsay now. She is testify-

(Testimony of Sybelle E. Faul.)

ing about something her husband told her about what went on at [27] the office. I object.

Mr. Heisler: I thought I was asking her if she overheard any conversation between her husband and Mr. Shurlock. Mr. Sherlock represented the Government, so it would not be hearsay.

The Court: Read the question.

(Whereupon the last question was read.)

Q. (By Mr. Heisler): Do you recall such a conversation?

A. Yes. They evidently didn't know how to use this tremendous bookkeeping machine, so they were practicing evidently for hours with all the papers, all the papers were thrown around the office, because I saw this myself, and they jammed the machine so badly, with these false entries, that when the bookkeeper came back she couldn't operate it. They had to have a great deal of work done on it.

Q. Do you recall that in May, 1950, Mr. Boland called your husband to come to San Francisco for a certain purpose? A. Yes.

Q. Did you go with your husband?

A. Yes. I went with my husband, I thought we were coming to the Internal Revenue Building, but instead he had us come to his apartment which he then lived in.

Q. Did he ask for any additional information of your husband? [28]

A. Well, yes; my husband went into the kitchen,

(Testimony of Sybelle E. Faul.)

he was very high-strung and nervous and he said he didn't want to go without me, and I had to go with him, he said, because he didn't know his purpose for seeing him. And really nothing much took place, because they were talking in the kitchen for a short time and then they came out and we left.

Q. Was Mr. Boland a personal friend of yours or your husband's?

A. No. We never saw him except in connection with this case.

Q. Do you recall a letter written to your husband by Mr. Parsons, Assistant Secretary of the Treasury in Washington, in the fall of 1950?

A. Yes, sir.

Q. And do you recall substantially what was in that letter?

A. They had to have more information before they could pay him his reward, it was impossible to give it to him unless they went back over the books and got more information. And they also told him that when we were in New York.

Mr. Boyle: I object. Your Honor, this is not the best evidence. It is hearsay, too.

Mr. Heisler: If Your Honor please, I wrote to Mr. Boyle, and I would like to ask him whether he would be kind enough to submit as our exhibit a copy of Mr. Parsons' letter [29] of October, 1950, informing Mr. Faul that such additional information is needed.

Mr. Boyle: Did you find it?

(Testimony of Sybelle E. Faul.)

Mr. Heisler: No, but I think I can find it. I can give you the exact date.

Mr. Boyle: There is no objection. That letter can go in.

The Court: Do you have the letter?

Mr. Heisler: I don't have, Your Honor, a copy of the letter at all.

The Court: Can you furnish that letter?

Mr. Boyle: Yes, we can furnish a copy of the letter.

Mr. Heisler: Fine. That may be, then, attached to the stipulation as Petitioners' Exhibit A-2?

Mr. Boyle: To be.

Mr. Heisler: To be, fine.

Mr. Boyle: You just make that your own.

Mr. Heisler: I say, Petitioners'.

Mr. Boyle: That won't be the proper exhibit number, then.

Mr. Heisler: All right, then, I make it Petitioners' Exhibit 1.

The Court: 2. Exhibit 2 will be furnished separately [30]

(Petitioners' Exhibit No. 2 to be furnished.)

Q. (By Mr. Heisler): After this letter was received by Mr. Faul, do you know whether Mr. Shurlock came again to your house in Carmel to talk to Mr. Faul? A. This was in 1950?

Q. 1950, yes. A. Yes, sir.

Q. Do you know what the conversation was about?

(Testimony of Sybelle E. Faul.)

A. It was never over anything between the two of them but the Government case.

Q. Do you recall a particular conversation in '50 or '51 between Mr. Shurlock and your husband concerning the fraud penalties against the Myers Company?

A. Yes; he told them there wouldn't be, he didn't think there would be a fraud penalty but if there were a fraud penalty it would be a great amount.

Mr. Boyle: I object, unless you lay a proper foundation for her being present and so forth.

Mr. Heisler: I can do so. I am sorry.

Q. (By Mr. Heisler): Do you recall any conversation between Mr. Shurlock, the Government agent, and your husband in Carmel, California, when you were present and where the conversation pertained to [31] any possible fraud penalty to be assessed against the Myers Company?

A. Yes. I think he, at the time, said it would be $500,000.00 fraud penalty.

Mr. Boyle: I object, Your Honor. There is no proper foundation laid yet for that. Who was present, when did it take place, and where did it take place?

Mr. Heisler: We are coming to that.

Q. (By Mr. Heisler): You recall such conversation, is that right? A. Yes.

Q. Where was the conversation?

A. In my home in Carmel.

Q. About what time of the day was that?

(Testimony of Sybelle E. Faul.)

A. I think about 2:00 o'clock in the afternoon.

Q. Who was present?

A. Mr. Shurlock's wife and myself and my husband and Mr. Shurlock.

Q. The four of you?

A. And Mr. Shurlock, yes; Mr. Shurlock, his wife, my husband and I.

Q. The four of you? A. Yes.

Q. Will you please tell the judge now what was said by whom? [32]

A. Well, he felt that if——

Q. (Interrupting): Who is "he"?

A. Mr. Shurlock was the one who said that the fraud would be about $500,000.00, the penalty, and if it were that much his reward would be twice as much as what he thought it was going to be.

Q. Did Mr. Shurlock at that time ask Mr. Faul to supply any additional information?

A. That I don't remember.

Q. In 1952 your husband received a reward in the approximate amount of $68,000.00?

A. Yes, sir.

Q. Do you recall any tax payment that was made by him on this reward? A. Yes.

Q. Do you remember the approximate amount?

Mr. Boyle: If Your Honor please, this is all a matter of record, and we have the returns which will go in——

Mr. Heisler: Fine.

Mr. Boyle: Can we shortcut this thing?

Mr. Heisler: Fine. Can it also be stipulated, sir,

(Testimony of Sybelle E. Faul.)

that there was a payment of $28,000.00 on the first estimate and that there was a refund of $8,825.46? Right?

Mr. Boyle: Yes.

Mr. Heisler: I am sorry, your Honor. It will be [33] stipulated that that was the amount first paid and that there was a repayment and reimbursement in the amount of $8,825.46.

The Reporter: Did you say "Yes," Mr. Boyle?

Mr. Boyle: I didn't make any remark.

Mr. Heisler: It may go in?

(No response.)

Mr. Heisler: At this time I would like to submit a partial stipulation of facts made by Counsel and myself.

The Court: Are there any exhibits attached to it?

Mr. Heisler: We will submit exhibits, yes.

The Clerk: There are none attached to it now.

The Court: The stipulation will be received.

Mr. Boyle: There is only one exhibit that will be attached so far, and that is the Form 211. The other exhibits will go in as the exhibits of the respective parties, as the respective parties introduce them, rather than attached to that.

Mr. Heisler: If Your Honor please, I would like to ask Counsel for the Government to supply us copies of the certificate dated March 21, 1952. This certificate is No. 2021588, issued by the General Refunding Office in Claim No. S-962662, in the amount of $68,387.96, chargeable to the account, "Salaries and Expenses, Bureau of Internal Revenue, 1952."

(Testimony of Sybelle E. Faul.)

May we have such a copy, sir? [34]

Mr. Boyle: If Your Honor please, the original of that must have been sent to the Petitioner. The Internal Revenue file contains no copy, so if there is a copy, it presumably is with the General Accounting Office.

Mr. Heisler: I see. If you don't have any copy—I thought you had a copy—we have none of these documents, and that was the reason I was asking in my letter whether you could help us.

If Your Honor please, I would like to ask the Court's permission to go over the files of the Government which Counsel so kindly permitted me to see, and if there are any exhibits which I would like to introduce into evidence I will ask for the approval of Counsel.

Mr. Boyle: If Your Honor please, this particular file that Counsel is referring to is merely a letter file during which, from about 1950 until 1952, during which time Mr. Faul was writing many letters asking for his reward—we have no objection to Petitioner putting those in evidence, but we do not think they have any probative value or that they are material to the case. We have no objection, however, if he wants them in.

Mr. Heisler: I see here some documents dated 1947.

Mr. Boyle: I beg your pardon, Counsel. There are about three documents in 1947 where the Form 211 was sent back to Washington to the Chief

(Testimony of Sybelle E. Faul.)

Counsel, and the Chief Counsel [35] notified Mr. Faul that "We have received your informer's claim, it has been assigned a claim number and you will hear from us eventually." That is the only purpose.

Mr. Heisler: Of course, I don't want to introduce in evidence anything that has no probative value, but I would like to go over it, if I may. Do you have any objection to that?

(No response.)

Q. (By Mr. Heisler): During 1952 you filed a tax return in which you included the $68,000.00 reward, is that correct? A. Yes.

Q. And then you received a deficiency assessment in the amount of $18,350.00, is that corect?

A. Yes.

Q. Mrs. Faul, did you personally ever receive any part of the $68,000.00 of the reward?

A. No, sir, I did not.

Q. All monies went to your husband?

A. Yes, sir.

Q. You don't know what happened to the money, do you? A. I borrowed $10,000.00.

Q. From him? A. Yes, sir.

Q. Did you pay it back to him? [36]

A. Yes.

Q. Out of a little business which you maintain yourself? A. Yes, sir.

Mr. Heisler: That is all.

The Court: Just a moment.

(Testimony of Sybelle E. Faul.)

Cross-Examination

Q. (By Mr. Boyle): Was your husband an employee of the Salinas Valley Ice Company in 1944?

A. No. It was Ralph Myers Company. I don't know if they called it both the same or not, but I think it was Ralph Myers Company. You see, they were two, the ice company was a little different from the Ralph Myers Company. The Ralph Myers Company was a packing company and the ice company was just an ice company, nothing else, just ice, it supplied ice. And I understood the father, you see——

Q. (Interrupting): That is enough.

Mr. Boyle: If I may, to clear the record, Your Honor, I would like to say that there is one corporation involved here, the Salinas Valley Ice Company, and there were also individual returns filed by Ralph E. Myers, but there were no returns filed by any Ralph E. Myers Company, and that that is not a legitimate company except that it was just a fictitious name used for the operations of the Salinas [37] Valley Ice Company.

Is that correct, Counsel?

Mr. Heisler: I have here on your file, on the letterhead of the Internal Revenue Service, signed by Mr. James E. Smith, Collector, who writes on March 3, 1947, for the Bureau of Internal Revenue, Washington, D. C., and he says, "This claim of Mr. Faul's pertains to the alleged violation of the In-

(Testimony of Sybelle E. Faul.)

ternal Revenue laws by Ralph E. Myers Company, Salinas, California." So——

Mr. Boyle (Interrupting): If Your Honor please, there was confusion until this case came back and was set straight by Mr. Shurlock, the examining agent, and he will take the stand, and I think it would be better to wait and let him clear it up.

The Court: Any other cross-examination?

Mr. Boyle: Yes.

Q. (By Mr. Boyle): Was your husband an employee of Mr. Ralph Myers in 1945?

A. Yes, and in 1946, yes.

Q. In 1946? A. Yes.

Q. Why didn't your husband furnish this information to the Government in those years, for instance, 1944?

A. Well, maybe they didn't ask for it. You see, he [38] didn't have the records, only information.

Q. Why didn't he furnish that information in 1944? Did he ever tell you why?

A. No. He gave them everything they asked for and everything they wanted. Maybe they didn't want the records.

Q. He knew at that time that the company was defrauding the Government? A. Yes, sir.

Q. And he was an employee at that time?

A. Yes.

Q. Your husband did not inform on the company until after he was fired, is that right?

A. Yes.

(Testimony of Sybelle E. Faul.)

Q. What is your answer, please?

A. That is right.

Q. Did your husband write a threatening letter to Mr. Boland in 1950?

A. Not to my knowledge. My goodness, no. If he did, I didn't know it.

The Court: I couldn't hear you.

The Witness: Not to my knowledge, he didn't.

Q. (By Mr. Boyle): Were you personal friends of Mr. and Mrs. Shurlock?

A. Only through the work that they were doing, only—I had never knew them before in my life, never. I don't believe [39] we had anything in common, only for this Government case.

Q. Did you ever invite Mr. and Mrs. Shurlock to your home?

A. They always came through business.

Q. Did you invite them?

A. No. My husband did.

Q. Were you ever in their home?

A. One evening, yes, with my children.

Q. Pardon?

A. Yes, I was, yes, one evening with my children.

Q. Did you go there by invitation?

A. Yes. It was with regard to my husband. He wanted to give some type of information to Shurlock——

Q. (Interrupting): That is all. Thank you.

Do you recall a Christmas party at which, during which you had the Shurlocks, to which you invited

(Testimony of Sybelle E. Faul.)

the Shurlocks, Mr. and Mrs. Shurlock, when Mr. Ketchum, the cartoonist, was also present?

A. No, sir.

Q. You don't recall such an occasion?

A. I don't recall the Shurlocks being with us, no.

Q. Your answer, then, is that they were not there?

A. They may have dropped in, but I had no invitation extended to them.

Q. Do you recall their being there? [40]

A. No, I don't, no.

Q. Do you recall the party? A. Yes, I do.

Q. When did it take place?

A. Shortly after we moved in our home.

Q. When would that be? A. In '49.

Q. Would that be a Christmas party in 1949?

A. No, because we moved in in January, so it couldn't have been.

Q. Do you recall the date of the party?

A. No. But it was after Christmas, because we couldn't get in our house for Christmas. It was impossible, it just wasn't finished. We were dreadfully upset over it, but we couldn't get into it.

Q. Did you have anything in common with Mrs. Shurlock? A. No.

Q. How many times would you say Mr. and Mrs. Shurlock were in your home?

A. Well, during that period of time that—from '46 to '50, oh, dear, maybe 30 times.

Q. Mrs. Shurlock was there 30 times?

(Testimony of Sybelle E. Faul.)

A. Not always she. He was there, but not always with her.

Q. But she was there a great number of times, is that correct? [41] A. Yes.

Q. Mrs. Faul, you mentioned that in 1944 your husband approached the Internal Revenue Service. Is that correct? A. Yes.

Q. With whom did he speak?

A. I don't know, because I wasn't with him. He came here, and I thought it was Mr. Boland at the time. Was Mr. Boland with the Internal Revenue?

Q. What is your understanding, that he came to San Francisco?

A. He came to San Francisco, he phoned for an appointment and came. I came with him to San Francisco, and I stayed in the car, I didn't come up into the building.

Q. What address in San Francisco did you come to?

A. Well, when we drove up to this building today, I was so positive this was the one we came to.

Q. This building?

A. I don't know. I really don't know San Francisco too well. I have never lived here and I don't really know San Francisco too well.

Q. Did your husband tell Mr. Myers that he had made this visit to the Internal Revenue Service?

A. No. And he only did it to protect himself at that time, so as to have records when it came up, that surely someone would find out there was a

(Testimony of Sybelle E. Faul.)

fraud, and the person he [42] contacted at that time——

Mr. Boyle (Interrupting): That is all, Your Honor.

Redirect Examination

By Mr. Heisler:

Q. You testified that Mr. Shurlock came to your house from 1947 to 1950 about 30 times and sometimes Mrs. Shurlock came with him. When Mrs. Shurlock came to the house, what happened? Did you all sit together or what happened?

A. No, no.

Q. What happened?

A. She played the piano, and she was always at our piano, she wrote music and she was always at the piano playing when she came.

Q. And where was Mr. Shurlock?

A. He was always with Elmer.

Q. In the same room or in a separate room?

A. Not always in the same room, no, sir.

Q. Did you ever hear Mrs. Shurlock complaining to Mr. Shurlock?

A. She said we could have fun together if it wasn't always for business. And that was all the conversation.

Mr. Heisler: That is all.

The Court: You are excused.

(Witness excused.)

Mr. Heisler: There was a letter to a [43] threatening letter, and I was wondering whether it could

be followed up, because I know nothing about it.

The Court: Have you any other witnesses?

Mr. Heisler: No other witnesses, your Honor. That is the Petitioners' case.

The Court: Mr. Boyle?

Mr. Boyle: Mr. Shurlock.

Whereupon,

ALAN RUSSELL SHURLOCK

was called as a witness on behalf of the Respondent and having been first duly sworn, testified as follows:

The Court: State your name, please.

The Witness: Alan Russell Shurlock.

Mr. Boyle: I offer in evidence the 1952 Individual Income Tax Return for Elmer J. and Sybelle E. Faul. I will ask that I be permitted to withdraw the original and substitute a photostatic copy in place thereof.

The Court: That will be done.

Respondent's Exhibit B in evidence.

(Respondent's Exhibit B was marked for identification and was received in evidence.)

Direct Examination

By Mr. Boyle:

Q. Mr. Shurlock, by whom are you employed?

A. The Internal Revenue Service. [44]

Q. What is your position?

A. Internal Revenue Agent.

Q. How long have you been an Agent?

(Testimony of Alan Russell Shurlock.)

A. Since July 1, 1935.

Q. Where are you stationed now?

A. San Francisco, California.

Q. Have you always been stationed in San Francisco? A. No, sir.

Q. Would you briefly describe where your post of duty has been in the past?

A. I entered the Service in New York, Second New York Division, on July 1, 1935. I was transferred to the Seattle Division on or about October of 1938. I was transferred to the San Francisco Division about October 1940. I was given a post of duty at Monterey, California, about May 1, 1941. I was transferred to San Francisco about February of 1949. That is where I am at present.

Q. Do you know the Petitioner, Elmer J. Faul?

A. Yes, sir.

Q. What was the occasion of your meeting Mr. Faul?

A. I was making an audit of a Section 722 claim filed by the Salinas Valley Ice Company for the years 1940 and '41 at Salinas, California.

Q. And you met Mr. Faul at that time?

A. Mr. Faul was the Office Manager of the Salinas Valley [45] Ice Company at the branch office known as the Ralph E. Myers Company.

Q. Will you please explain to the Court the business purpose and function and business entity known as the Ralph E. Myers Company?

A. Salinas Valley Ice Company had two branches, an Ice Division which sold ice, manufac-

(Testimony of Alan Russell Shurlock.)

tured ice, and a Packing and Farming Division which was known as the Ralph E. Myers Company. Two separate sets of books were kept, but one, a subsidiary set of books, they were controlled in one ledger.

Q. Was the Ralph E. Myers Company a corporation? A. No, sir. Just a branch, a name.

Q. A trade name? A. That is right.

Q. It filed no tax returns?

A. That is right; no, sir.

Q. Did you have occasion to meet Mr. Faul for any other purpose than the Section 722 claim of the Salinas Valley Ice Company?

A. At a later date, yes.

Q. Will you explain what date that was and what the occasion was?

A. The date was some time in April of 1947. The occasion was at Mr. and Mrs. Faul's house in Salinas, with Mr. O'Connell. [46]

Q. Who was Mr. O'Connell?

A. Mr. O'Connell was the Fraud Contact Agent for the San Francisco Division of the Internal Revenue Service.

Q. Had he come to Montery to see you?

A. Yes, he had. He had come to me and discussed certain allegations made of fraud.

Q. On whose part?

A. On the part of the Salinas Valley Ice Company, filed by Mr. Elmer Faul.

Q. You mean the allegations of fraud were filed by Mr. Elmer Faul, is that right?

(Testimony of Alan Russell Shurlock.)

A. That is right.

Q. In other words, Mr. Faul was an informer, is that right? A. He was an informer, yes, sir.

Q. At or about that time did you receive a list of the allegations?

A. My recollection is that it was about that time or shortly after when the file came down for the returns filed by the Salinas Valley Ice Company for the years '42 to '46, inclusive. The file may have come with that.

Q. How many items were on this list?

A. As I recall it, there was an original list of about 45 allegations. Subsequently I think additional amounts were furnished by Mr. Faul which added up to about a total of 68 [47] or 70.

Q. What was the form of the list, on what type of paper?

A. It was on a blank sheet of yellow paper 8½ by 11, written, typewritten, with no headings, just as a sort of a brief outline of each of the, of the matter involved in each allegation. It wasn't signed or anything at all. It was just merely typewritten notes.

Q. When did you start your audit of the Salinas Valley Ice Company? A. May of 1947.

Q. Did you see Mr. Faul in connection with the list of allegations? A. Yes, sir.

Q. When?

A. I would say all through the summer of 1947 I was in contact with Mr. Faul, through until about the fall of '47, I worked with him, I got in touch

(Testimony of Alan Russell Shurlock.)

with him quite often in connection with, as we went through these various allegations.

Q. When did he furnish you with these additional items between, beyond and up to 68 or 70, as you have testified?

A. He was employed at some other place in Salinas at the time, I think it was some tractor company, and I would visit him there and he would furnish them to me at that time.

Q. When did you receive the last of the items involved?

A. I would say sometime about June of '47. [48]

Q. When did you submit your final report on the Salinas Valley Ice Company?

A. In July of 1948.

Q. In July of 1948? A. Yes, sir.

Q. What course did the case of the Salinas Valley Ice Company then take, after you submitted your report?

A. According to procedure, no discussion of the adjustments was made with the taxpayers at all, because it was a fraud case. I submitted my report and in the course of time a protest was filed to the report.

Q. Where in the Internal Revenue Service did the case go, after it left you, that is?

A. It went to the Conference Section, sir.

Q. Do you know who the Conferee was?

A. Mr. Bruce Brace.

Q. Where was he located?

A. He was located on Battery Street, I believe

(Testimony of Alan Russell Shurlock.)

on 53 Battery Street, or it was 74 New Montgomery Street at that time.

Q. In what city? A. San Francisco.

Q. In other words, the entire case and file was sent to San Francisco after it left you, is that right?

A. Right in the same building.

Q. How far is Monterey from San Francisco, approximately? [49]

A. 120 miles.

Q. Where is Carmel in connection with Monterey? A. About four miles south.

Q. And where is Salinas from there?

A. 20 miles from Monterey.

Q. Did you discuss the case with the Conferee after, while it was in his hands? A. Yes, sir.

Q. A number of times?

A. I attended a conference, a preliminary conference, with the Conferee and with the attorney.

Q. Was Mr. Faul present? A. No, sir.

Q. To your knowledge, did Mr. Faul ever solicit or have a conference with the Conferee?

A. Not to my knowledge.

Q. To your knowledge, did the Conferee ever meet Faul? A. Not to my knowledge.

Q. When was the Salinas Valley Ice Company case closed, if you know?

A. In my recollection, it was closed around 1950.

Q. When was the last time that you discussed the Salinas Valley Ice Company case with Faul for the purpose of understanding the list of allegations that he had furnished?

(Testimony of Alan Russell Shurlock.)

A. I would say about September of 1947. [50]

Q. September of 1947, is that right?

A. That is right. That is within a month or so, but I am not sure.

Q. Did you see Mr. Faul after that time?

A. Yes, I saw him. He moved to Carmel in '48.

Q. Where were you living then?

A. I was living in Carmel. My post of duty was in Monterey, but Carmel was only four miles south of Monterey.

Q. And those cities were three or four miles, are three or four miles apart? A. Yes.

Q. And he moved to Carmel in 1948?

A. I believe so. I was instrumental in helping him get a position in a packing house in Monterey.

Q. At that time? A. In '48, yes.

Q. Where did you see Mr. Faul in 1948 and '49, if you saw him in those years?

A. I would say most of the time at his home.

Q. Were you personal friends?

A. Yes, I would say so. We got to like each other. As far as the case was concerned, the case was closed.

Q. Did your wife ever accompany you?

A. Certainly. She and Mrs. Faul were good friends.

Q. Did they have anything in common? [51]

A. Mrs. Faul and Mrs. Shurlock seemed to be interested in music a lot; they played the piano a lot.

Q. Was Mrs. Shurlock ever invited to their house? A. Yes.

(Testimony of Alan Russell Shurlock.)

Q. Were they ever in your house?

A. I think so; two or three times, I would say.

Q. In discussing, in conversing with Mr. Faul, what was the nature of your conversations in those years, 1948 and 1949?

A. Generally speaking, it went to, it went on, "When am I going to get my reward?" That was the tenor of the conversation.

Q. Was there any reminiscence about this matter?

A. Yes, there was quite a bit. We would discuss some of the issues involved, in which he had furnished information, and I would discuss, go over the points with him, that we brought out.

Q. Was Mr. Faul furnishing any information to you at that time in connection with the case?

A. No. The case—None whatever.

Q. In other words, the last information he furnished to you, as you testified, was in the fall of 1947, is that right?

A. Yes, that is the best of my knowledge.

Q. Who was Frank Myers?

A. Frank Myers was the President of the Salinas Valley Ice Company. [52]

Q. Who was Ralph Myers?

A. His son. He was the manager of the Ralph E. Myers Company, the branch, Farming and Vegetable Branch.

Q. Was there ever an indication that Frank Myers was involved in defrauding the Government?

A. We did not find any whatever, sir.

(Testimony of Alan Russell Shurlock.)

Q. You never found any indication that Frank Myers was involved, is that right?

A. No, sir. The books of the ice company were—the branch books of the ice company were good, in good condition. There was no evidence of fraudulent transactions in those books. All the fraudulent transactions took place in the books of the Ralph E. Myers Company branch.

Q. And who was the manager of that?

A. Ralph E. Myers.

Q. When did he die?

A. I understand he died in '46, in June of '46.

Mr. Boyle: What was the date of that?

Mr. Heisler: September 10, 1951, from William W. Parsons.

Q. (By Mr. Boyle): Mr. Shurlock, were you ever asked to write a report assessing the value, if any, of this information furnished by Mr. Faul, which served for the Government purposes?

A. Yes, sir. [53]

Q. Do you remember when you submitted that report? A. I think it was about May of 1950.

Q. Just in general, what was the substance of your report? What did you purport to do in that report?

Mr. Heisler: I object, your Honor. I think that if the Government has the report, that would be the best evidence.

Mr. Boyle: If your Honor please, it goes into the details of the Salinas Valley Ice Company case and I would like to confine the case, if possible, to this

(Testimony of Alan Russell Shurlock.)

taxpayer and not get into the person informed upon any more than is necessary. I don't think any purpose would be served in putting that in. I just want to bring out what Mr. Shurlock was doing in writing such a report.

Mr. Heisler: Well, I have no desire to have the complete report introduced into evidence, but I would like to see the assessment, because there Mr. Shurlock may, contrary to his testimony, refer to subsequent additional information from Mr. Faul, after June or July or September of 1948, and I think that is important for the purpose of the hearing here.

The Court: Did you wish to have it submitted?

Mr. Heisler: I would like to have the report as it pertains to the evaluation of the information supplied by Mr. Faul, because that would obviously refer to the dates and the additional information received from Mr. Faul, and that may be [54] in contradiction to Mr. Shurlock's statement.

The Court: Let's proceed.

Have you anything further, Mr. Boyle?

Mr. Boyle: Yes, I have a few more questions, your Honor.

Q. (By Mr. Boyle): By whom were you instructed to prepare that report, Mr. Shurlock?

A. That, in accordance with the Internal Revenue procedure, in cases where there are rewards.

Q. For what purpose?

A. The purpose is to inform the Government as

(Testimony of Alan Russell Shurlock.)

to the value of the information furnished by the informer and to determine the amount of reward.

Mr. Boyle: I offer in evidence a letter to Mr. Boland from Mr. Emler J. Faul, dated April 13, 1951.

The Court: Is there any objection?

Mr. Heisler: No objection, your Honor.

The Clerk: Respondent's Exhibit C in evidence.

(Respondent's Exhibit C was marked for identification and was received in evidence.)

RESPONDENT'S EXHIBIT C

Carmel, California

April 13th, 1951.

Mr. John J. Boland,
Acting Chief Field Deputy,
100 McAllister Street,
San Francisco, California.

Dear Mr. Boland: Referring to JJB:SFD:825

Nearly 3 weeks have elapsed since receiving your letter of March 26th advising me that you expected to have some information regards to my Claim for Reward in the above Case. This matter of no replies but promises has been going on for several years as your files as well as the ones in Washington will readily show. I have been constantly pushed around

(Testimony of Alan Russell Shurlock.)

and ignored, therefore, I feel that it has reached the point where it will be necessary for me to use other steps unless same is taken care of on or before May 1, 1951.

The government, so I understand, has been paid in full their share several months ago, therefore, I fail to understand why I have not received my share.

As you can see from our leading metropolis newspapers, recently there has been scandal connected with your Department in Salinas as well as other points in our State of California, and if this case should be brought out in the light it will not be very pleasant for many concerned. You know yourself there was fraud connected with this case, this party was never exposed—did not lose his license to do business and is still operating.

I feel that I have not been treated fair and unless it is taken care of with a substantial reward as per above, it will be necessary for me to find another way to secure what is due me.

Very truly yours,

/s/ ELMER J. FAUL.

C/C Chas. Oliphant, Chief Counsel—US Treas. Dept. Bureau Int. Rev., Washington 25, DC

Received in evidence June 24, 1957. [55-A]

(Testimony of Alan Russell Shurlock.)

Mr. Boyle: I offer in evidence as Respondent's next exhibit in order a letter to Mr. Parsons from Mr. Faul, dated September 4, 1951.

Mr. Heisler: No objection. [55]

The Court: It will be received.

The Clerk: Respondent's Exhibit D in evidence.

(Respondent's Exhibit D was marked for identification and was received in evidence.)

RESPONDENT'S EXHIBIT D

Carmel, Calif.

Sept. 4, 1951.

Air Mail

Mr. William W. Parsons,
Adm. Assist. Secty.,
Treasury Dept.,
Washington, D. C.

Dear Mr. Parsons: Re: Reward Claim No. A-412190

I am in receipt of your airmail letter of Aug. 9th, 1951, advising me that my claim is receiving active consideration. But still another month will have elapsed in a very few days since I last heard from you and no reward has been received.

Mr. Bolland of your San Francisco office advised me several months ago that all papers had been

(Testimony of Alan Russell Shurlock.)

forwarded to Wash., D. C., in connection with this case and that I should receive my reward shortly.

Just all the delay in paying same I cannot understand as several months have elapsed, however, I realize this is one of the largest cases in the history of your Dept. and naturally expect my reward to be in proportion.

Anything that you can do to expedite same will be greatly appreciated and trust same will be forthcoming before the close of month of September.

Thanking you for an early reply and if possible a warrant, I am,

Sincerely yours,

/s/ ELMER J. FAUL,
P. O. Box 248—Carmel, Calif.

Received in evidence June 24, 1957. [56-A]

Mr. Boyle: I offer as Respondent's next exhibit in order a letter to the Commissioner of Internal Revenue from Mr. Faul, dated March 27, 1950.

Mr. Heisler: No objection.

The Court: It may be received.

The Clerk: Exhibit E in evidence.

(Respondent's Exhibit E was marked for identification and was received in evidence.)

RESPONDENT'S EXHIBIT E

RECEIVED IN
MAR 27 1950
CHIEF COUNSEL'S OFFICE
FOR THE
BUREAU OF INTERNAL REVENUE

Carmel, California,

March 27, 1950.

Commissioner of Internal Revenue,

Washington, D. C.

Dear Sir: Re: Salinas Valley Ice Co.- Tax Evasion & Fraud.

On Feb. 22, 1947, I reported to Mr. John Boland of your San Francisco Office the above case, with records to support my claim. Shortly thereafter your Mr. Jack O'Connell of your S. F. Office called upon me with several other representatives of his department. At that time I was residing at 217 Lajaro St. Salinas, Calif. but about 2 years ago I moved to Carmel, Cal., where I am now residing, post office address below. During the past years I have contacted Mr. O'Connell personally whenever I happened to be in San Francisco to ascertain how the case was progressing as understood it took a long time checking the records and recently he referred me back to Mr. Boland whom in turn advised me he had heard nothing from Washington D.C. as Mr O'Connell's records on this particular case would be sent to [redacted], D. C. and shortly thereafter the amount of tax's would be send to him to collect. I was in San Francisco about a month ago and Mr. Boland said he had heard nothing and when I was in San Francisco last Friday- March 24th, 1950, and I contacted Mr. O'Connell whom suggested that I write you direct to ascertain present status of this case. Mr.O'Connell as his local representative Alan Shurlock conferred with me numerous times during first 2 years after I reported this case for information.

At the time I reported this case originally to Mr. Boland, I signed a paper protecting the [redacted] and that the matter was thoroughly investigated and settled so please let me hear from you in the near future, as over 3 years have elapsed and I thought it surely must be settled by now.

Thanking you in advance for an early reply, I am,

Very truly yours,

[redacted]
Carmel, Calif.

April 5, 1950.

MISS DAVIS,
ROOM 5320:

I do not believe a new case is needed at this time upon thebasis of Mr. Faul's letter, as it is apparent he has the taxpayer involved in his pending claim confused with another company. Just send the letter along, cross referencing to our case.

A. I. Monroe

TAX COURT OF THE U.S.
MARKED FOR IDENTIFICATION
ADMITTED IN EVIDENCE
JUN 24 1957
PETITIONER'S EXHIBIT
RESPONDENT'S EXHIBIT E
DOCKET NO. 52844

Received March 27 1950.

Mr. Boyle: If your Honor please, these are part of the Government's file, so I ask permission to withdraw these, and I will substitute photostatic copies.

The Court: That will be done.

Mr. Boyle: That is all, your Honor.

Mr. Heisler: I have some cross-examination.

Cross-Examination

Q. (By Mr. Heisler): Mr. Shurlock, you stated on direct examination that Mr. Faul supplied prior to the beginning of your investigation allegations numbering about 45, and that subsequently he supplied added information, making a total number of allegations of about 68; is that correct? [56]

A. Yes, sir.

Q. When were these additional, about 23, allegations supplied to you or to the other Agents?

A. They were supplied to me between April of '47 and I would say about July of 1947.

Q. You testified on direct examination, you said that you met with Mr. Elmer J. Faul concerning the Salinas Valley Ice Company the last time in June, 1947; then you stated that it may have been in September of '47. A. Yes, sir.

Q. So which date is the correct one?

A. I would think September would probably be the correct one.

Q. And after September '47 he supplied no information and you asked him for no enlightenment and no data; is that correct?

A. That is correct, to the best of my recollection.

(Testimony of Alan Russell Shurlock.)

Mr. Heisler: I am offering into evidence a letter written by Mr. William W. Parsons, Administrative Assistant Secretary of the Treasury, on September 10, 1951, to Mr. Faul, and I want to have this document marked, your Honor, as Petitioners' Exhibit 3.

The Court: Will you submit it to the Clerk to be marked for identification?

(Petitioner's Exhibit No. 3 was marked for identification.) [57]

The Court: Will there be objection to these?

Mr. Heisler: I want the Court's permission to withdraw these to make photostatic copies of these documents.

The Court: It will be received.

The Clerk: Petitioner's Exhibit 3 in evidence.

(Petitioner's Exhibit No. 3 was received in evidence.)

PETITIONER'S EXHIBIT No. 3

September 10, 1951.

Dear Mr. Faul:

Receipt is acknowledged of your letter of September 4, 1951, concerning your Reward Claim No. A-412190.

As I stated in my letter of August 9, 1951, your claim is receiving active consideration and everything possible is being done to expedite the case. However, it has been found necessary to request ad-

(Testimony of Alan Russell Shurlock.)

ditional information from the field office in California and your case cannot be concluded until that information is received at headquarters.

You may be assured that upon receipt of this additional information every consideration will be given to bringing this matter to a final conclusion.

Very truly yours,

/s/ WILLIAM W. PARSONS,
Administrative Assistant
Secretary.

Received in evidence June 24, 1957. [58-A]

Q. (By Mr. Heisler): Do you know that on September 10, 1951, Mr. Parsons wrote to Mr. Faul, among others, and I am quoting: "It has been necessary to request additional information from the Field Office in California, and your case cannot be concluded until that information is received at headquarters." Did you know that Mr. Parsons of the Washington Office asked the Field Office with which you were connected for additional information on this Myers tax matter?

A. Was that Salinas Valley Ice or Ralph E. Myers?

Q. Well, whatever the case, the matter is not captioned, but it refers only to Mr. Faul's claim numbered A-414190. Whatever the heading is, I

(Testimony of Alan Russell Shurlock.)

don't know. The Department did not caption the letter.

A. Well, I can't give you any information on that. I put my reports in before that time.

Mr. Heisler: I would like to ask that this other document, Mr. Faul's letter of November 9, 1951, be marked [58] Petitioner's Exhibit 4.

The Court: It will be so marked.

The Clerk: Petitioner's Exhibit 4 for identification.

(Petitioner's Exhibit No. 4 was marked for identification.)

The Court: Do you offer this in evidence?

Mr. Heisler: I would like to offer this in evidence.

Mr. Boyle: No objection.

The Court: It will be received.

The Clerk: Petitioner's Exhibit 4 in evidence.

(Petitioner's Exhibit No. 4 was received in evidence.)

PETITIONER'S EXHIBIT No. 4

Air Mail

Carmel, California

Nov. 9, 1951.

Mr. William W. Parsons,
Administrative Assist. Secty.,
Treasury Dept.,
Washington, D. C.

(Testimony of Alan Russell Shurlock.)

Dear Mr. Parsons: Re: Reward Claim No. A-412190.

I received your letter of Sept. 10th relative to the above claim; nearly 2 months have elapsed again and still I have not received my reward. In your letter of the above date you stated that you were awaiting additional information from your field office here in California. I am wondering if this has been recd. and if so when I can expect my reward. I dislike writing you so often on this matter but this claim has been hanging fire since Feb., 1947 which will be 5 years in 3 more months and inasmuch as the amounts due the Govt. were collected in full early part of this year, 1951, it seems only in order that my part should be forthcoming by this time. So please do not think I am "pesty" by writing you so often but I feel that I am entitled to some consideration inasmuch as this was one of the largest cases ever collected by your Department and I do not think I should be constantly ignored. I feel that I have done all in my power to cooperate with your various people that called upon me for additional information from time to time so hope that upon receipt of this letter you will have all necessary information and forward me my check in full, and if not, please try to rush same along and oblige,

Very truly yours,

/s/ ELMER J. FAUL,
P. O. Box 248—Carmel, Calif.

Received November 14, 1951.
Received in evidence June 24, 1957.

(Testimony of Alan Russell Shurlock.)

Q. (By Mr. Heisler): Did you know that on November 9, 1951, Mr. Faul wrote to Mr. William W. Parsons, Administrative Assistant Secretary, Treasury Department, and in this, among others, he stated: "I feel that I have done all in my power to co-operate with your various people that called upon me for additional information from time to time." Do you know whether it is true or false what Mr. Faul wrote in November, 1951 that he co-operated with the agents who called upon him from time to time for additional information?

A. Speaking from my own experience, I would say that he co-operated fully with me.

Q. But did he co-operate and supply the additional [59] information after September, 1947?

A. Not to my knowledge.

Q. If that is the case, why is it that your report evaluating his services was not dated until May 11, 1950? Why were you waiting from September, 1947 to May, 1950 to make an evaluation, if there was no information supplied in the intervening time?

A. After I wrote my report, the case, according to Internal Revenue procedure, is transmitted to the Conference Section for further action. Until that case is finally disposed of, that report that you referred to cannot be written.

Q. Incidentally, who was the Conference officer, please? A. Mr. Bruce Brace.

Q. Did you see his report, conference report?

A. I can't be sure whether I saw it or not.

(Testimony of Alan Russell Shurlock.)

Q. Do you know that he recommended a fraud assessment of about 50 per cent?

A. I am not sure—I have forgotten what he did do, because it was out of my hands, it was his work and not mine.

Q. Do you remember that you made the report contrary to Mr. Brace's report, recommending against fraud assessments?

A. No, I don't recall that I did.

Q. Do you remember that the Conference Officer wrote a subsequent report and pointed out that his recommendation was to assess for fraud and that the Field Agent, Mr. Shurlock, [60] recommended against it? Do you recall that?

A. No. I would have to refresh my mind with looking at my report. It's so long ago, I wouldn't remember what I recommended.

Q. All right. Now, Mr. Shurlock, you don't remember whether or not you recommended against the Conference Officer for the fraud assessment, but you remember that the last time you met Mr. Faul was in September, 1947. Why is it that you remember one so well and you don't remember the other at all?

A. Which case are you talking about, sir.

Q. I am talking about that you don't remember that you recommended against the fraud assessment.

A. On which taxpayer?

Q. On the Myers matter, Salinas, whatever the name is.

A. There are three taxpayers involved. There

(Testimony of Alan Russell Shurlock.)

are the Salinas Ice Company, Ralph Myers and his wife. Which one are you referring to?

Q. I don't remember. There was only one case, you testified there was only one company, with two branches, and that there were no returns made by the branches, only by the company. So in consequence there could not have been three fraud assessments, is that correct?

A. No, sir, it isn't correct.

Q. All right.

A. Just a minute. There are two individual taxpayers [61] who filed returns and there is one corporate taxpayer.

Q. Yes?

A. The fraud penalty may be assessed against any of those three.

Q. My question is, however, Mr. Shurlock: Now, as you are sitting there, you do not remember whether you recommended against assessments of fraud penalty; on the other hand, you received the last information from Mr. Faul in September, 1947. How come, how is it that one is so much more important to remember after ten years, while the other is so unimportant that you don't remember until you go back to your records?

A. Well, the first one is the start of the case. I remember things very clearly at the start of the case.

Q. Now, you stated that you were assigned to the case in April, 1947 and that you had at that time about 45 items of allegations of fraud, that you ex-

(Testimony of Alan Russell Shurlock.)

amined those 45 and you discussed the other 23 later supplied by Mr. Faul, and all that work was finished from April '47 to September '47. Is that correct?

A. No. I discussed it with them, but the report wasn't submitted until a year later, until July of '48.

Q. In July, '48 you submitted your report, but from September, '47 to July, '48 you never talked to Mr. Faul about any of the information that he had?

A. I can't be sure that I never talked to him about it. [62]

Q. So, then, if you cannot be sure, when do you think you could have talked to him? Could you have talked to him in May, 1948?

A. No, I don't think—it might have been within a month or so of September.

Q. So it could have been October or November?

A. Yes.

Q. So it could have been October or November, 1947?

A. Yes. I was finished about that time, as far as the preliminary examination was concerned.

Q. Do you recall at all that there was any recommendation of fraud penalty to be assessed either against the Salinas Ice Company or against Ralph E. Myers or his estate after he died?

A. Yes, there was.

Q. Was there finally an assessment made for fraud?

A. I believe there was on the Conference Report, but I did not handle that.

Q. On the Conference Report there was a recom-

(Testimony of Alan Russell Shurlock.)

mendation for a fraud assessment. And what was your recommendation? Do you recall?

A. Fraud.

Q. Did you not recommend against it?

A. Not on the Salinas Valley Ice Company.

Q. On what? [63]

Mr. Boyle: Let's confine it to Salinas Valley. The individual returns and the reports on Myers are not before us in this case. So let us confine it to the party informed upon, upon which he was paid the reward.

Mr. Heisler: If your Honor please, I would like to point out that this report, dated May 11, 1950, that Counsel produced here, refers not only to the Salinas Valley Ice Company, but also to Frank S. Myers, Ivy Myers, and Ralph E. Myers.

Mr. Boyle: That is true, but that has nothing to do with this case.

Mr. Heisler: There is apparently a recommendation in the same report that there should be a 5 per cent negligence charge against the Salinas Ice Company and a 50 per cent fraud assessment against the Ralph E. Myers Company, because Ralph E. Myers was the beneficiary of the fraud.

Mr. Boyle: This report covered both, but the Myers returns are not involved in this case, so there is no reason to go into it.

The Court: I might point out further, you are not trying this case before a jury.

Q. (By Mr. Heisler): Mr. Shurlock, did you report to your superiors concerning the value of in-

(Testimony of Alan Russell Shurlock.)

formation supplied by Mr. Faul as follows, on page 5 of your report of May 11, 1950: [64]

"The information furnished by the informer was of good value in the investigation. Generally speaking, it was specific, based on facts and conveying details which save time in running down leads and resulted in large adjustments to taxable net income."

Did you write that, Mr. Shurlock?

Mr. Boyle: We will stipulate this. The informer was paid. He gave information and he was paid. There is no reason to go into this.

Q. (By Mr. Heisler): Did you write that, do you know?

The Court: I sustain the objection.

Q. (By Mr. Heisler): When you wrote about the details of information, what did you have in mind? Did you have in mind just the summary of information or additional documents that you received from Mr. Faul?

A. I had in mind the 68 allegations.

Q. That is all? A. That is all.

Q. You never received anything from him, any documentary evidence, further studies or copies of other documents made by him, of the books and records of the Salinas Valley Ice Company or of Ralph E. Myers Company? A. No, sir. [65]

Q. When did you move from Monterey to San Francisco, or to Berkeley, Mr. Shurlock?

A. I moved from—my post of duty was moved from Monterey to San Francisco in February of 1949.

(Testimony of Alan Russell Shurlock.)

Q. Did you thereafter visit Mr. Faul at his home in Carmel?

A. I believe I was down there sometimes, yes.

Q. How many times did you visit from San Francisco down there? A. I recall once.

Q. Was that a purely personal visit or did you go down to get any additional information on the tax matter?

A. I had some tax work to do in the city, but nothing to do with him. The call was purely personal.

Mr. Heisler: That is all, Mr. Shurlock.

Redirect Examination

By Mr. Boyle:

Q. Is it not true that in your report of July, 1948 you recommended fraud against the Salinas Valley Ice Company and that the Conferee eliminated it and put in the 5 per cent negligence penalty in place thereof?

A. Yes, sir. That is my recollection.

Mr. Boyle: That is all, your Honor.

The Court: You are excused.

(Witness excused.) [66]

The Court: Is there any other evidence?

Mr. Heisler: That is all, your Honor.

Mr. Boyle: The Government rests.

The Court: I will allow you 60 days for simultaneous briefs and 30 days thereafter for a reply.

The Clerk: The dates for those briefs are, original briefs August 26, the reply briefs September 25.

(Whereupon, at 11:50 o'clock, a.m., Monday, June 24, 1957, the hearing in the above-entitled matter was closed.)

Filed July 9, 1957, T.C.U.S. [67]

[Title of Court of Appeals and Cause.]

PETITION FOR REVIEW

To the Honorable Chief Judge and the Circuit Judges of the United States Court of Appeals for the Ninth Circuit:

Elmer J. Faul and Sybell E. Faul, petitioners, ask this Court to review the Decision of the Tax Court of the United States entered on December 12, 1957, wherein it was held that petitioners have not established that Elmer J. Faul, one of the petitioners, performed services for the Bureau of Internal Revenue over a thirty-six (36) month period, and hence they may not claim the benefit of Section 107(a), Internal Revenue Code of 1939. Decision was entered by said Tax Court of the United States on the 12th day of December, 1957, for respondent Commissioner of Internal Revenue, and on that date it was ordered and decided that there is a deficiency in income tax of petitioners in the amount of Eighteen Thousand Three Hundred Fifty and 23/100 ($18,350.23) Dollars for the taxable year 1952.

I.

Names and addresses of petitioners:

(a) Elmer J. Faul, 875 Filbert Street, Apt. 2, San Francisco 11, California.

(b) Sybell E. Faul, P. O. Box 248, Carmel, California.

II.

Taxable period involved: The year of 1952.

III.

Tax return filed: Office of Internal Revenue Department, Salinas, Monterey County, California.

IV.

Court in which review is sought: United States Court of Appeals for the Ninth Circuit.

V.

Nature of controversy: Petitioner Elmer J. Faul was a full time employee, but not in charge of the tax records, of the R. E. Myers Company of Salinas, Monterey County, California, from February, 1941 to March, 1946. He discovered that the employing company made certain improper charges against the taxable income account. On February 2, 1947, he informed the Collector of Internal Revenue, San Francisco, California, of such improper charges and indicated that he had documentary proof thereof. The Department, on February 22, 1947, asked peti-

tioner Elmer J. Faul to continue accumulating evidence and asked him to file Form 211 for informant's reward, which he did as Claim No. 8990. Thereafter, petitioner Elmer J. Faul was repeatedly interviewed by various agents of the Bureau to whom he gave information as to the alleged improper charges by the company. On the basis of the information supplied, the Bureau recovered additional taxes from the R. E. Myers Company, and on February 18, 1952, petitioner received a reward of Sixty-Eight Thousand Eight Hundred Thirty-Seven and 96/100 ($68,837.96) Dollars.

Petitioners filed an estimated tax return on the above reward and made a tax payment of Twenty-five Thousand Eight Hundred Twenty-five and 82/100 ($25,825.82) Dollars.

Petitioners, in their income tax return for the year of 1952, claimed the benefit of Section 107(a) of the Internal Revenue Code of 1939, and they were given a refund of Eight Thousand Eight Hundred Twenty-five and 46/100 ($8,825.46) Dollars; however, subsequently, respondent determined that the sum of Sixty-eight Thousand Eight Hundred Thirty-seven and 96/100 ($68,837.96) Dollars received by petitioner as compensation for personal services "was not compensation for personal services covering a period of thirty-six (36) calendar months, or more, within the meaning of Section 107(a) of the Internal Revenue Code * * *" and, further determined that said amount is includable in full in petitioners' gross income for the year of 1952. On the

basis of such holding by respondent, a claim for deficiency in the amount of Eighteen Thousand Three Hundred Fifty and 23/100 ($18,350.23) Dollars was assessed against petitioners.

VI.

The issue to be determined on review: Whether petitioners properly applied the benefit of Section 107(a) of the Internal Revenue Code of 1939 on their 1952 income tax return to the award of Sixty-eight Thousand Eight Hundred Thirty-seven and 96/100 ($68,837.96) Dollars; whether the deficiency claimed by respondent in the amount of Eighteen Thousand Three Hundred Fifty and 23/100 ($18,-350.23) Dollars, or any amount, is due from petitioners.

Wherefore, petitioners respectfully ask that the holding of the United States Tax Court of December 12, 1957, which holding is adverse to petitioners, may be reviewed by this Honorable Court.

Dated, Carmel, California, March 10, 1958.

Respectfully submitted,

HEISLER & STEWART,

By /s/ FRANCIS HEISLER,
Attorneys for Petitioners.

Received and filed March 11, 1958, T.C.U.S.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To the Chief Counsel, Internal Revenue Service, Washington, D. C.:

Please take notice that Elmer J. Faul and Sybell E. Faul, petitioners in the above-entitled cause, filed on the 11th day of March, 1958, with the Tax Court of the United States, Box 70, Washington 4, D. C., their petition that the United States Circuit Court of Appeals for the Ninth Circuit reviews the Decision of the United States Tax Court of December 12, 1957. A copy of said petition for review is herewith served upon you.

Dated, Carmel, California, March 10, 1958.

HEISLER & STEWART,

By /s/ FRANCIS HEISLER,
Attorneys for Petitioners.

Service of copy acknowledged.

Filed March 13, 1958, T.C.U.S.

[Title of Court of Appeals and Cause.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 15, inclusive, constitute and are all of the original papers on file in my office as called for by the "Designation of Contents of Record on Review," including Joint Exhibit 1-A, Petitioner's Exhibits 3 and 4, admitted in evidence, but excepting Petitioner's Exhibit 2, which was never furnished to the Court, and Respondent's Exhibits B, C, D and E, admitted in evidence, in the case before the Tax Court of the United States, docketed at the above number and in which the petitioners in the Tax Court have filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 3rd day of April, 1958.

[Seal] HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Endorsed]: No. 15987. United States Court of Appeals for the Ninth Circuit. Elmer J. Faul and Sybell E. Faul, Petitioners vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed April 14, 1958.

Docketed: April 18, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Apppeals
for the Ninth Circuit

No. 15987

ELMER J. FAUL and SYBELL E. FAUL,

Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

STATEMENT OF POINTS RELIED UPON BY APPELLANTS

The appellants Elmer J. Faul and Sybell E. Faul will submit to the United States Court of Appeals for the Ninth Circuit the following points of issue in urging the review of the decision of the United States Tax Court of December 12, 1957:

1. Appellants are entitled to the benefit of Section 107(a) of the Internal Revenue Code of 1939 with reference to their 1952 income tax return on which they reported as income an informant award of $68,837.96. Section 107(a) is applicable because appellant husband who supplied the information to the Internal Revenue Service expended more than thirty-six (36) months in gathering and supplying the information on which said award was based.

2. Services rendered by appellant husband in gathering and supplying information to the Internal

Revenue Service, on the basis of which information additional taxes were recovered by the Department, were personal services rendered within the meaning of Section 107(a) of the Internal Revenue Code. Such services covered a period longer than thirty-six (36) months; therefore, appellants in reporting the award of $68,837.96 on their 1952 joint income tax return, properly allocated the same over a period during which the services were rendered, and they are entitled to the benefits of said Section 107(a).

3. Appellant husband who informed the Internal Revenue Service as to the alleged irregularities on the books of a taxpayer, was instructed by said Service to proceed with the gathering of detailed information as to such alleged irregularities and complied with the instructions. The period, which was expended by him in gathering such information as instructed, is includable in the period during which personal services were rendered by appellant husband to the Internal Revenue Service in accordance with Section 107(a) of the Internal Revenue Code of 1939.

4. Appellant husband, having supplied to the Internal Revenue Service the information gathered by him concerning the alleged irregularities on the part of a certain taxpayer, was instructed by said Service to continue to supply to its explanations and clarifications of the information supplied, which appellant husband did. The period of time during which appellant husband was ready, willing and did supply such clarification and explanation to the In-

ternal Revenue Service is considered part of the period under Section 107(a), during which personal services were rendered.

5. The holding of the Tax Court that "an informer's award received by appellant husband of $68,837.96 did not qualify for treatment under Section 107(a), Internal Revenue Code of 1939, since services leading to award did not extend over a 36-month period" is erroneous because it is contrary to the fact.

6. The holding of the Tax Court that "an informer's award received by appellant husband of $68,837.96 did not qualify for treatment under Section 107(a), Internal Revenue Code of 1939, since services leading to award did not extend over a 36-month period" is erroneous because it is contrary to law.

7. The holding of the Tax Court that "an informer's award received by appellant husband of $68,837.96 did not qualify for treatment under Section 107(a), Internal Revenue Code of 1939, since services leading to award did not extend over a 36-month period" is erroneous because it is contrary to law and the facts.

8. The Tax Court's order and decision of December 12, 1957, "that there is a deficiency in income tax of $18,350.23 for the taxable year 1952," as far as these appellants are concerned, is erroneous because it is contrary to the facts.

9. The Tax Court's order and decision of December 12, 1957, "that there is a deficiency in income tax of $18,350.23 for the taxable year 1952," as far as these appellants are concerned, is erroneous because it is contrary to law.

10. The Tax Court's order and decision of December 12, 1957, "that there is a deficiency in income tax of $18,350.23 for the taxable year 1952," as far as these appellants are concerned, is erroneous because it is contrary to the facts and the law.

Dated, Carmel, California, April 24, 1958.

Respectfully submitted,

HEISLER & STEWART,

By /s/ FRANCIS HEISLER,
Attorneys for Appellants.

[Endorsed]: Filed April 25, 1958, U.S.C.A.

No. 15,987

IN THE

United States Court of Appeals

For the Ninth Circuit

ELMER J. FAUL and SYBELL E. FAUL,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition to Review a Decision of The Tax Court of the United States.

Honorable Ernest H. Van Fossen, Judge.

PETITIONERS' OPENING BRIEF.

HEISLER & STEWART,
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No. 15,987

IN THE

United States Court of Appeals

For the Ninth Circuit

ELMER J. FAUL and SYBELL E. FAUL,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**Petition to Review a Decision of
The Tax Court of the United States.
Honorable Ernest H. Van Fossen, Judge.**

PETITIONERS' OPENING BRIEF.

JURISDICTION.

This is a petition to review a decision of the Tax Court of the United States (Tr. 33), which decision was based on the finding of fact and opinion of said Court. (Tr. 23-33.)

The Tax Court of the United States had jurisdiction of the issues raised by the petition (Tr. 3-15) under the laws of the United States, particularly under 26 U.S.C.A. 7442 (I.R.C. 1954); 26 U.S.C.A. 107(a) (I.R.C. 1939); 26 U.S.C.A. 1301 (I.R.C. 1954).

The jurisdiction of the United States Tax Court was invoked by the petition (Tr. 3-15) on the ground

that respondent erred in holding that the reported income represented by informant's award in the amount of $68,837.96 received by petitioner husband (hereinafter called "husband") in 1952 allegedly as compensation for personal services rendered during a period of sixty-seven months, commencing in February 1944 and ending in September 1949, may not be prorated over said period in computation of petitioners' tax liability for said year. As further ground the petition alleged error on the part of respondent holding that Section 107(a) of Internal Revenue Code is not applicable to said income, but to the contrary that the same is includable in full in gross income for the year of 1952 in accordance with Sec. 22(a) of the Internal Revenue Code. (Tr. 3 and 4.) The trial was held on the 24th of June 1956 involving the issues raised by the petition (Tr. 3-15) and on the answer (Tr. 16-18) and stipulation filed (Tr. 20-23).

The decision (Tr. 33) ordered a deficiency in petitioners' income of $18,350.23 for the taxable year 1952, as it was originally determined by respondent (Tr. 3).

This Court has jurisdiction of the review under 26 U.S.C.A. Sec. 1141 (I.R.C. 1939), 26 U.S.C.A. 7482 (I.R.C. I954), as well as under Rule 29 of the Rules of this Court of May 27, 1923, as amended to June 18, 1956 and to August 21, 1957.

STATEMENT OF THE CASE.

Facts.

Petitioners are formerly husband and wife who were divorced after the filing of the petition in this

case before the United States Tax Court, that the interlocutory decree of divorce was entered in the Superior Court of the State of California in and for the County of San Francisco in Cause No. 449942 and entitled *Elmer J. Faul, Plaintiff v. Sybell E. Faul, Defendant.* Said decree was filed on the 29th day of December, 1955; a final decree of divorce was entered subsequently; and that petitioner Sybell E. Faul resides in Carmel, Monterey County, California, and that the other petitioner Elmer J. Faul resides in San Francisco, California. (Tr. 20.) They filed their joint income tax return for the year 1952 with the District Director of Internal Revenue, San Francisco, California. (Tr. 20.)

Petitioner Elmer J. Faul (hereinafter called husband) was a full time employee of the R. E. Myers Company of Salinas, Monterey County, California, from approximately February 1941 to March 1946. The R. E. Myers Company was a subsidiary of the Salinas Valley Ice Co. (also known as Salinas Ice Co., Ltd.) of Salinas, Monterey County, California. (Tr. 20, 21.) The tax records were kept and the tax returns for the above-named companies were prepared by one Emmett Gottenberg, a certified public accountant of San Jose, California. (Tr. 21.)

On February 22, 1947, husband had an interview in San Francisco with John Boland, Chief Field Deputy in the office of the Collector of Internal Revenue, San Francisco, California. At that time he submitted to Boland a memorandum of alleged violations of Internal Revenue laws by the Salinas Valley Ice Com-

pany. (Tr. 21.) On the same day, February 22, 1947, he filed Form 211 as Claim No. 8990. (Tr. 21.)

Beginning with the month of March 1947, husband was interviewed by Agent Allan Shurlock and other agents to whom he gave the above mentioned memoranda as to the alleged violations, by the Salinas Valley Ice Company, of the provisions of the Internal Revenue Code. (Tr. 21.) He also corresponded in writing with officials of the Internal Revenue Service and the Treasury Department. (Tr. 21.)

In April 1952, husband received a check in the amount of $68,837.96 as informer's award. (Tr. 22.)

The Collection Office of the Internal Revenue Service in Salinas, California, promptly demanded an estimated tax return and the payment of estimated tax with respect to the receipt by husband of the award of $68,837.96. Payment of tax pursuant to such estimated tax return was made by petitioners in the amount of $25,825.82. Thereafter, petitioners filed their income tax return for the year 1952 and in connection with the payment of said $68,837.96 they claimed the benefit of Section 107(a) of the Internal Revenue Code of 1939. Accordingly, the return indicated a tax liability of $17,150.02 and an overpayment of $8,825.46, which overpayment was refunded by the Internal Revenue Service to petitioners. (Tr. 22.)

Thereupon, respondent determined that said sum of $68,837.96 received by husband "was not compensation for personal services covering a period of thirty-six (36) calendar months or more within the meaning

of Section 107(a) of the Internal Revenue Code . . .", and further determined that "the said amount of $68,837.96 is includable in full in gross income for the year ended December 31, 1952, in accordance with Section 22(a) of the Internal Revenue Code . . ." The examining agent computed petitioners' tax liability based upon Section 11 and Section 12 of the Internal Revenue Code on the basis of which a deficiency of $18,350.23 was claimed. (Tr. 22, 23.)

Husband did not testify nor appear at the trial because, as his son Gene Faul testified (Tr. 10-12), he suffered a nervous breakdown and lately he was in a highly excitable state and appeared extremely nervous. This witness also stated that his father wrote to him recently numerous letters which indicated that his father's nervous condition would not qualify him to testify in this case. (Tr. 42 and 43.)

Sybell E. Faul, petitioner (hereinafter referred to as the wife), testified on direct examination in this cause (Tr. 44-70) that she had been married to husband for thirty-one (31) years (Tr. 44); that his present condition was such that he would not be able to take the witness stand and tell a coherent story. (Tr. 45.)

Husband first went to work for R. E. Myers Co. as office manager in 1941 while living in Watsonville, California. (Tr. 45.) His immediate employer was Ralph Myers. His place of work was Salinas, California, (Tr. 45) commuting between his residence and the place of employment. Upon the insistence of Ralph Myers, petitioners moved in 1942 to Salinas. (Tr. 45.)

The wife was present at petitioners' home at various times after 1942 and heard conversations between husband and Ralph Myers. Husband pointed out that his employer was making enough money and that he ought not to cheat on his books, exposing himself to tax fraud charges. Husband told his employer that unless the fraudulent bookkeeping ceased he will terminate his employment. Ralph Myers passed off the objections lightly by saying that husband did not have to do the book work, that he "will have someone else do it." (Tr. 46.) The someone else who was hired to do the tax work was Emmett Gottenberg, a certified public accountant of San Jose, California. (Tr. 46.)

Conversations between husband and his employer Ralph Myers pertaining to the fraudulent bookkeeping took place in 1942 and 1943. (Tr. 46.)

Husband kept on worrying in spite of his employer's assurance that he would not be involved in any tax fraud charges. The wife, to save husband from worrying, suggested to him in 1943 that he quit his job with R. E. Myers Co. Her advice was not taken. (Tr. 48.)

Husband went to San Francisco in 1944 to talk to some Government men to find out just what he should do to protect himself. They told him that he should make records and have evidence to prove that he was not involved in any fraud. (Tr. 48.) He began to keep records in February or March of 1944. (Tr. 49.) She saw her husband thereafter prepare records at home or at the office during very late hours at night. (Tr. 49.)

Wife went to the office of R. E. Myers Co. where husband showed her the false book entries of which he made copies. He also used to bring the books home and make copies on the typewriter there. (Tr. 49.) Husband continued making copies of the false book entries in 1945 and 1946 (Tr. 49) and kept those copies at home in an old safe (Tr. 50).

In July 1946 wife had a conversation with Ralph Myers at Tassajara Hot Springs, California with Gottenberg present. (Tr. 50.) Before this conversation took place, Ralph Myers telephoned wife while she was in Palm Springs, and told her that he was firing husband because he was interfering with the bookkeeping and with the ways the entries were made, even though another man was hired to keep the books. Ralph Myers told her that he wanted to do something for her and, therefore, offered her Tassajara Hot Springs which he then owned. That was in 1946 and husband was fired from his job in March of that year. (Tr. 50 and 51.) Ralph Myers offered in connection with her taking over Tassajara to pay the expenses until he had built a new hotel there, after which he expected the Hot Springs to become profitable. (Tr. 51.)

Wife took over the running of the Hot Springs and moved there in April 1946 with husband who assisted her with the bar and the books. (Tr. 51.)

In July 1946 at Tassajara, husband upbraided Gottenberg for making false entries on the books of the R. E. Myers Co., and that in consequence he lost his job with the company. Gottenberg answered that "it

isn't any of your business. You had no business interfering with it at all." Ralph Myers was present at this conversation but did not participate in it. He was inebriated. (Tr. 52.)

Petitioners remained at Tassajara from April to August 1946. In the latter month, Ralph Myers was killed in an airplane accident. Even though Ralph Myers always assured wife that none of his family would interfere with her running of the Springs, as soon as he died the family began interfering and demanded that she give up the place immediately. She protested that Ralph Myers gave her one-half (½) interest in the Springs, but the family denied that and Myers Sr. threatened petitioners to "break them" if they insisted in her claim, so they left Tassajara. (Tr. 53.)

Petitioners went to Salinas and husband suggested to wife that the Government be again informed of the false book entries. Wife opposed it, but husband did report it and made a claim for informer's award on Febuary 22, 1947. (Tr. 53, see Exhibit 1-A, Tr. 56 and 57.)

(It was stipulated that husband went with his information to the Internal Revenue Service in San Francisco prior to February 22, 1947. (Tr. 55.))

Petitioners went together with the information concerning fraudulent bookkeeping by the R. E. Myers Co. to one John J. Boland, Deputy Collector of the Internal Revenue Service in San Francisco. (Tr. 59, see Exhibit 1-A.) Boland told husband that he would have to have a great deal more information than he

supplied at that visit, and he also told petitioners that his agents would contact them. (Tr. 59.) It was not long after that, that Van Schroeder, Shurlock and another agent, Jack O'Connell, of the Internal Revenue Service came to petitioners' home in Salinas. (Tr. 59.)

Thereafter, the Revenue Agents were in petitioners' home for a long time. It seemed to wife that they were coming back for an eternity. There were Government men in the house until wife felt that it was not her home but the Internal Revenue Bureau. (Tr. 59.)

After several years of coming and going on the part of the Internal Revenue Agents to the petitioners' home in Salinas, husband became extremely nervous, and petitioners moved to Carmel in 1948. (Tr. 59.)

The Internal Revenue Agents came to petitioners' home for the purpose of obtaining information as to Ralph Myer's fraud. (Tr. 59.) Agents Schroeder and Shurlock assured husband that the Internal Revenue Service would never have found any of the fraud and any of the false entries if it hadn't been for his help. (Tr. 59.) The Internal Revenue Agents were in petitioners' home in 1948 in connection with the tax information. The agents were always asking husband for information and wife is sure that he supplied them with plenty of it. It seemed to the wife that the Revenue Agents were in her home all the time in 1948. (Tr. 60.)

In 1949 husband saw only Revenue Agent Shurlock who always came to their home in Carmel on the Government case. Shurlock never was an intimate

friend and wife did not know him before this Government case came into her life. (Tr. 60 and 61.)

Petitioners bought their Carmel home and moved into it in January 1949. Agent Shurlock came there in 1949 to get information on the Myers' case. Husband and Agent Shurlock always met with reference to the Government case. Wife saw the two of them taking out the records and the files that husband had collected during the years since 1944. (Tr. 61.)

Those who made the false entries did not know how to use the big bookkeeping machine and used it while the operator was on her vacation. They evidently practiced for hours, and wife saw the practice papers which had been thrown all around the office. They jammed the bookkeeping machine and when the operator came back from her vacation, she couldn't operate it. They had to have a great deal of repair work done on the machine. (Tr. 61 and 62.)

Wife recalls that Mr. Boland called husband in 1950 to come to San Francisco. She went with him and thought that they were going to the Internal Revenue Building, but Boland had them come to his apartment. He asked husband for additional information. (Tr. 62 and 63.) Petitioners never saw Boland except in connection with the Myers' tax case. (Tr. 63.)

Wife recalls a letter written in 1950 to husband by Mr. Parsons, Assistant Secretary of the Treasury in Washington. This letter said that they had to have more information on the Myers' tax case before they

could pay him his reward. The letter also said that he could not be paid his reward unless they went back over the books and got more information. The same thing was told to husband when petitioners were in New York. (Tr. 63.) (See Exhibit 3, Parson's letter of September 10, 1951.) (Tr. 92 and 93.)

Internal Revenue Agent Shurlock came to petitioners' home in Carmel in 1950 to talk to husband. The conversation between the two was never about anything else but the Government case. (Tr. 64 and 65.)

Wife recalls a conversation between Agent Shurlock and husband in 1950 or 1951 pertaining to the fraud penalty against the Myers Co. Shurlock did not think that there would be a penalty, but if there were one, it would be a large amount. (Tr. 65.)

Agent Shurlock, his wife, and petitioners were in petitioners' house in 1950 or 1951, when Shurlock said that the Myers' fraud penalty would be about $500,000, and if the penalty turned out to be as much then husband's reward would be twice as much as Shurlock first thought it to be. (Tr. 65 and 66.)

Husband received in 1952 an informer's award of $68,837.96. Petitioners filed an estimated tax return and they paid an estimated tax on the award of $28,000.00. A refund of $8,825.46 was made by the Revenue Service to petitioners. (Tr. 67.)

Wife received no part of the $68,837.96 informer's award, all of which was kept by the husband. The wife borrowed $10,000 from the husband, but she paid it back to him in full. (Tr. 69.)

Form No. 211, part of Exhibit 1-A, shows that the husband's claim in the amount of $68,837.96 was allowed in the case of "Salinas Valley Ice. Co., Ltd. and Ralph E. Myers, Deceased" to be paid as "Salaries and Expenses, Bureau of Internal Revenue." The claim for award (Exhibit 1-A) refers to information supplied by husband "which led to detection of a violation of the Internal Revenue laws of the United States by Ralph E. Myers Co., Salinas, California." Goverment attorneys claimed that the Ralph E. Myers Co. "was just a fictitious name used for the operations of the Salinas Valley Ice Company" (Tr. 57, part of Exhibit 1-A, Tr. 70.)

The husband, while working for Ralph Myers in 1944, 1945 and 1946, did not supply the Government with the tax fraud records, because the Government did not ask for them. (Tr. 71.) The husband gave the Government "everything they asked for and everything they wanted. Maybe they did not want the records." (Tr. 71.)

From 1946 to 1950 Government Agent Shurlock was in petitioners' home maybe thirty (30) times. (Tr. 73.)

When in 1944 petitioners went to San Francisco, the husband phoned to the Internal Revenue Service for an appointment, and the wife believes that he saw Mr. Boland of the Revenue Service. The husband went to see the Revenue Service in 1944 to protect himself at that time. (Tr. 74.)

When Revenue Agent Shurlock came to petitioners' home from 1947 to 1950 and brought Mrs. Shurlock

with him, she would be playing the piano while Agent Surlock was always with husband. Mrs. Shurlock complained that they could have fun if the visits were not always for business. (Tr. 75.)

Allan Russell Shurlock (hereinafter and hereinbefore for the sake of brevity referred to as Agent or Agent Shurlock) testified that he was employed by the Internal Revenue Service, and that he became acquainted with husband in 1940 or 1941, while making an audit of a claim filed by Salinas Valley Ice. Co. Husband was at that time office manager of a branch office of the Ice Co. known as Ralph E. Myers Co. (Tr. 77 and 78.) Agent met husband later again in April 1947 at petitioners' home in Salinas. Fraud contact Agent O'Connell of the San Francisco Division of the Internal Revenue Service was also present. (Tr. 78.)

O'Connell came to see Agent Shurlock in Monterey to discuss with him certain fraud allegations filed by husband against Salinas Valley Ice Co. (Tr. 78.) The original contained about 45 fraud allegations. Subsequently, husband supplied additional items making a total of about 68 or 70 fraud allegations. (Tr. 78 and 79.) The allegations supplied by husband were typewritten and contained a brief outline of the matter contained in each. (Tr. 79.)

The audit was started in May 1947 and Agent Shurlock saw husband in connection with the list of allegations. Agent Shurlock had contact with husband all through the summer of 1947 until about the fall of 1947. Agent Shurlock worked with husband and

got in touch with him quite often in connection with the various allegations. The two of them went through these various allegations. (Tr. 79 and 80.)

Husband supplied the last of the 68 or 70 fraud allegations about June 1947. (Tr. 80.)

Agent Shurlock submitted his final report on the Salinas Valley Ice Co. in July 1948. (Tr. 80.) A protest was filed to the report and the case went to the Conference Section. The conferee was Bruce Brace. (Tr. 80.)

According to Agent Shurlock's recollection, the case of the Salinas Valley Ice Co. was closed around 1950. (Tr. 81.) He discussed the case with husband the last time about September 1947. (Tr. 81 and 82.)

Agent Shurlock saw husband after September 1947. He saw him most of the time at petitioners' home in Carmel. They were personal friends. (Tr. 82.) Mrs. Shurlock and wife were good friends, they played the piano together. (Tr. 82.)

Petitioners were two or three times in the home of Agent Shurlock. (Tr. 83.)

In 1948 and 1949 the nature of conversations between Agent Shurlock and husband generally speaking was "When am I going to get my reward?" (Tr. 83.) There was quite a bit of reminiscing about the tax matter. The two of them would "discuss some of the issues involved" in which husband had furnished information. Agent Shurlock would discuss and "go over the points" with husband that the agents brought out. (Tr. 83.) The best knowledge of Agent Shurlock

is that husband furnished the last information in the fall of 1947. (Tr. 83.)

Frank Myers was the president of the Salinas Valley Ice Co., his son was Ralph Myers, the manager of the Ralph E. Myers Company of the Farming and Vegetable Branch. (Tr. 83.)

There wasn't any indication that Frank Myers was involved in defrauding the Government. All the fraudulent transactions took place in the books of the Ralph E. Myers Company branch. (Tr. 83 and 84.) Ralph E. Myers died in 1946. (Tr. 84.)

Agent Shurlock was asked by his superiors to write a report assessing the value, if any, of the information furnished by husband, which information served the Government's purposes. (Tr. 84.) He submitted such report in about May 1950. (Tr. 84.)

(Petitioners' Exhibit #4 is a letter dated November 9, 1951 from husband to Administrative Assistant Secretary Parsons of the Treasury Department. (Tr. 94 and 95.) In this letter husband wrote, among others, ". . . I feel that I have done all in my power to cooperate with your various people that called upon me for additional information from time to time . . .") Agent Shurlock speaking from his experience would say that husband cooperated fully with him. (Tr. 96.)

Agent Shurlock was assigned to the Myers' fraud case in April 1947 and he at that time had some 45 items of fraud allegations to examine. He also ex-

amined the 23 supplemental allegations of fraud supplied by husband later. Agent Shurlock's report was not submitted until July 1948. Agent "can't be sure" that he never talked to husband about the fraud allegations from September 1947 to July 1948. (Tr. 98 and 99.)

Even though Agent Shurlock can't be sure that he did not talk to husband about the fraud case between September 1947 and July 1948, he does not believe that he talked to him in May 1948. (Tr. 99.) He could have talked to husband within a month of September — it could have been October or November 1947. (Tr. 99.)

(It was stipulated that Agent Shurlock reported to his superiors on May 11, 1950 that "The information supplied by the informer (i.e. husband) was of good value in the investigation, generally speaking, it was specific, based on facts and conveying details which saved time in running down leads and resulted in large adjustment to taxable net income." (Tr. 101.))

When Agent Shurlock wrote in his report about "details of information," he had in mind the 68 allegations supplied by husband, that is all. He never received from husband "any documentary evidence, further studies or copies of other documents made by him of the books and records" of the companies involved in the tax fraud. (Tr. 101.)

Findings of Fact and Opinion (Tr. 23-33) and Decision (Tr. 33) adverse to petitioners was entered on December 17, 1957.

Questions Involved.

(1) Whether petitioners properly applied the benefit of Section 107(a) of the Internal Revenue Code of 1939 on their 1952 income tax return to the award of Sixty-eight Thousand Eight Hundred Thirty-seven and 96/100 ($68,837.96) Dollars.

(2) Whether the deficiency claimed by respondent in the amount of Eighteen Thousand Three Hundred Fifty and 23/100 ($18,350.23) Dollars, or any amount, is due from petitioners.

SPECIFICATION OF ERRORS.

1. Appellants are entitled to the benefit of Section 107(a) of the Internal Revenue Code of 1939 with reference to their 1952 income tax return on which they reported as income an informant award of $68,837.96. Section 107(a) is applicable because appellant husband who supplied the information to the Internal Revenue Service expended more than thirty-six (36) months in gathering and supplying the information on which said award was based.

2. Services rendered by appellant husband in gathering and supplying information to the Internal Revenue Service, on the basis of which information additional taxes were recovered by the Department were personal services rendered within the meaning of Section 107(a) of the Internal Revenue Code. Such services covered a period longer than thirty-six (36) months; therefore, appellants in reporting the award

of $68,837.96 on their 1952 joint income tax return, properly allocated the same over a period during which the services were rendered, and they are entitled to the benefits of said Section 107(a).

3. Appellant husband who informed the Internal Revenue Service as to the alleged irregularities on the books of a taxpayer, was instructed by said Service to proceed with the gathering of detailed information as to such alleged irregularities and complied with the instructions. The period, which was expended by him in gathering such information as instructed, is includable in the period during which personal services were rendered by appellant husband to the Internal Revenue Service in accordance with Section 107(a) of the Internal Revenue Code of 1939.

4. Appellant husband, having supplied to the Internal Revenue Service the information gathered by him concerning the alleged irregularities on the part of a certain taxpayer, was instructed by said Service to continue to supply to it explanations and clarifications of the information supplied, which appellant husband did. The period of time during which appellant husband was ready, willing and did supply such clarification and explanation to the Internal Revenue Service is considered part of the period under Section 107(a) during which personal services were rendered.

5. The holding of the Tax Court that "an informer's award received by appellant husband of $68,837.96 did not qualify for treatment under Section 107(a),

Internal Revenue Code of 1939, since services leading to award did not extend over a 36-month period'' is erroneous because it is contrary to the fact.

6. The holding of the Tax Court that ''an informer's award received by appellant husband of $68,837.96 did not qualify for treatment under Section 107(a), Internal Revenue Code of 1939, since services leading to award did not extend over a 36-month period'' is erroneous because it is contrary to law.

7. The holding of the Tax Court that ''an informer's award received by appellant husband of $68,837.96 did not qualify for treatment under Section 107(a), Internal Revenue Code of 1939, since services leading to award did not extend over a 36-month period'' is erroneous because it is contrary to law and the facts.

8. The Tax Court's order and decision of December 12, 1957, ''that there is a deficiency in income tax of $18,350.23 for the taxable year 1952,'' as far as these appellants are concerned, is erroneous because it is contrary to the facts.

9. The Tax Court's order and decision of December 12, 1957, ''that there is a deficiency in income tax of $18,350.23 for the taxable year 1952,'' as far as these appellants are concerned, is erroneous because it is contrary to law.

10. The Tax Court's order and decision of December 12, 1957, ''that there is a deficiency in income tax of $18,350.23 for the taxable year 1952,'' as far as

these appellants are concerned, is erroneous because it is contrary to the facts and the law.

STATUTES INVOLVED.

26 U.S.C.A. Secs. 6211-15, Secs. 7442, 7453, 7482 and 7483 (I.R.C. 1954).

26 U.S.C.A. Sec. 22(a) (I.R.C. 1939); 26 U.S.C.A. Sec. 61 (I.R.C. 1954).

26 U.S.C.A. Sec. 107(a) (I.R.C. 1939); 26 U.S.C.A. Sec. 1301 (I.R.C. 1954).

26 U.S.C.A. Sec. 3792 (I.R.C. 1939); 26 U.S.C.A. Sec. 7623 (I.R.C. 1954); 26 U.S.C.A. Sec. 1141 (I.R.C. 1939).

ARGUMENT.

I.

APPELLANTS ARE ENTITLED TO THE BENEFIT OF SECTION 107(a) OF THE INTERNAL REVENUE CODE OF 1939 WITH REFERENCE TO THEIR 1952 INCOME TAX RETURN ON WHICH THEY REPORTED AS INCOME AN INFORMANT AWARD OF $68,837.96. SECTION 107(a) IS APPLICABLE BECAUSE APPELLANT HUSBAND WHO SUPPLIED THE INFORMATION TO THE INTERNAL REVENUE SERVICE EXPENDED MORE THAN THIRTY-SIX (36) MONTHS IN GATHERING AND SUPPLYING THE INFORMATION ON WHICH SAID AWARD WAS BASED.

The uncontradicted testimony shows that husband was an employee of the R. E. Myers Co. of Salinas, California. His employment began in February 1941 and continued until March 1946. (Tr. 45 and 51.) He was an office manager working under the immedi-

ate supervision of R. E. Myers. (Tr. 45.) He was not in charge of the tax records kept, nor did he prepare the tax returns, but that work evolved upon a certified public accountant named Emmett Gottenberg. (Tr. 46.)

During the years 1942 and 1943 husband repeatedly made objections to his employer R. E. Myers about alleged fraudulent tax entries on the books of the R. E. Myers Co., expressing misgivings about the practice and warning the employer that he will expose himself to tax fraud charges. The employer sloughed off the objections as well as the warnings by stating that the husband had nothing to do with the bookkeeping and with the tax matter, but that such work was done by the accountant Emmett Gottenberg. (Tr. 46.)

The alleged fraudulent tax practices having been continued and the husband being worried about possible involvement in future fraud charges, went in 1944, together with the wife, to San Francisco and talked there to some Government men to find out just what he should do to protect himself. The visit of 1944 was to the Internal Revenue Service where the husband may have seen a Mr. Boland of that Service. He was advised that he should make records, which he began to keep in February or March 1944. These records were prepared at home or at the office during very late hours at night. The copies made of the false book entries were kept in petitioners' home in an old safe. (Tr. 49 and 50.)

Just prior to March 1946 the employer Ralph Myers discharged husband for the reason that he was

"interfering with the bookkeeping of the company and with the ways the entries were made." His employment was terminated as of March 1946. (Tr. 50.)

To do something for the family after the husband was fired from his job as office manager, Ralph Myers offered to the wife one-half interest in his Tassajara Hot Springs, provided the wife would take over the management, which she did, taking her husband with her to assist her in the running of the place. (Tr. 51.)

While in Tassajara, the husband upbraided accountant Gottenberg for making the false entries on the books of the R. E. Myers Co., and also that because of the false bookkeeping he, the husband, lost his job. Gottenberg justified himself by saying that the bookkeeping was not the husband's business and that he had no right to interfere therewith. (Tr. 52.)

In the summer of 1946 Ralph Myers was killed in an accident, and thereafter his family insisted that petitioners give up not only the management but also all interest in the Tassajara Hot Springs, and when they demurred by claiming one-half interest having been given to them by the late Ralph Myers, they were threatened by the family and gave up Tassajara. (Tr. 53.) The husband continued being disturbed about the false tax entries on the books of the R. E. Myers Co. and went to San Francisco to the Internal Revenue Service in February 1947. The wife accompanied him when he saw J. J. Boland,

Deputy Collector of the Internal Revenue Service in San Francisco. The husband reported about his observation and about the copies of the false bookkeeping records of his former employer, and Boland asked him for a great deal more information than he supplied at that second visit. Petitioners were also informed by said Boland that Internal Revenue agents were going to contact them. That was accordingly done and three Internal Revenue agents came to visit petitioners' home to obtain information concerning the fraud of the taxpayer. (Tr. 59.)

Internal Revenue agents were coming back to petitioners' home for a long time that seemed to continue for an eternity. Their visits were pertaining to information as to the tax fraud. The agents assured husband that but for his information and records the Department never would have found any proof of the tax fraud. The agents received from husband, first about forty-five fraud allegations, and subsequently, another twenty-three or so, making a total of sixty-eight or seventy allegations. These allegations were typewritten and contained a brief outline of the matter. (Tr. 60 and 61, 79, 80, 91.) The audit of the books of the fraudulent taxpayer began in May 1947 and husband supplied the information to the agents, working with them, going over the various allegations until the fall of 1947. (Tr. 82, 83, 91.) The agents' final report on the fraud of the taxpayer was transmitted in July 1948. (Tr. 80.)

From the above testimony, which remains uncontradicted on the record, the husband began preparing

copies of fraudulent tax entries on his employer's books not later than March 1944, after he consulted with Boland of the Internal Revenue Department in San Francisco. (Tr. 48.) He gathered information and made the copies on his own time, late at night. (Tr. 49.) He supplied about forty-five fraud specifications in February 1947 (Tr. 79), and supplied about twenty-three more in June 1947. He worked with the agents, going over the allegations in connection with the tax charges, until at least September 1947 or the fall of 1947. (Tr. 81, 82.)

The information supplied by the husband resulted in large adjustment to tax net income of the fradulent taxpayer. (Tr. 101.) The award of $68,837.96 was allowed to him in the case of "Salinas Valley Ice Co., Ltd., R. E. Myers, deceased" to be paid to him as "salaries, expenses, Bureau of Internal Revenue." (Exhibit 1-A, Tr. 57.)

The award paid to husband was for personal services rendered by him to the Bureau of Internal Revenue, and the rendering of these services began not later than March 1944 and did not cease earlier than September 1947, thus covered a period of three years and seven months for a total of forty-three months.

Petitioners claim that the award of $68,837.96 received by them in 1952 is taxable invoking the benefits of Section 107(a) of the Internal Revenue Code.

Respondent maintained during the trial of this cause that husband's services, if any, began in February 1947 when he supplied the written specifications

and terminated in the fall of 1947, covering less than thirty-six months. However, it was held that

> "It's a matter of common knowledge that a large proportion of professional employment does not occur under accurate contracts stipulating in advance the terms of payment."
>
> *Guy C. Myers,* 11 U.S.T.C. 447.

In the instant case the Internal Revenue Department advised the husband to keep records and copies of the alleged fraudulent book entries of his employer. He did so, beginning not later than March 1944. He prepared those copies on his own time late at night, either at home or in his office, and therefore, these were extraordinary services done on his own time for the benefit of the Internal Revenue Department. Having worked in preparing the records for a period not less than forty-three months, the compensation received by the husband in the form of award is to be considered compensation for long term services and may be spread over a period of such services and reported for tax accordingly. So it was held in *Harry L. Addison,* 3 U.S.T.C. 427.

Respondent, in denying petitioners' right to apply Section 107(a) of the Internal Revenue Code to the calculation of the tax due on the award of $68,837.96, seems to claim that the services rendered by informant are not personal services contemplated in said section. Such contention is contrary to reason. The services rendered were personal services, and since they were performed during a period covering more than thirty-six months the benefits of Section 107(a) accrue.

In the case of *Herbert Stein,* 14 U.S.T.C. 494, it was held that the amount of first prize award received by a taxpayer for his manuscript on post war employment given to him by a brewing company for advertising purposes was compensation for services. If the information supplied by taxpayer Stein to the brewing company was recognized by the court as compensation for "services," it is maintained that the information supplied by husband here to the Internal Revenue Department resulting in the recovery of substantial additional taxes is to be considered services and the award as compensation must be considered compensation for services rendered.

On the basis of the record as above which stands uncontradicted, and particularly on the testimony of wife which remained wholly uncontradicted, and of the decisions hereinabove and hereinafter cited and applicable to the facts, it is abundantly clear that the findings of fact of the Tax Court are so clearly erroneous that this Honorable Court ought to reverse the same; that it is respectfully submitted that this Court ought to hold that Section 107(a) of the Internal Revenue Code is applicable to the award of $68,837.96 received in 1952; and that the spreading of the award be for a period not less than forty-three months. Further, the findings of fact of the Tax Court are not supported by any evidence and ought to be reversed on the authority of *Maytag v. C.I.R.,* 187 F.2d 962. *Wisdom v. U. S.,* C.A. Cal. 1953, 205 F.2d 30. *Durwood v. C.I.R.,* C.C.A. 8, 1947, 159 F.2d 400.

On the basis of the record as above, which stands uncontradicted, and of the decisions hereinabove cited and applicable to the facts, it is respectfully submitted that this Court ought to hold that Section 107(a) of the Internal Revenue Code is applicable to the award of $68,837.96 received in 1952, and the spreading of the award be for a period not less than forty-three months.

II.

SERVICES RENDERED BY APPELLANT HUSBAND IN GATHERING AND SUPPLYING INFORMATION TO THE INTERNAL REVENUE SERVICE, ON THE BASIS OF WHICH INFORMATION ADDITIONAL TAXES WERE RECOVERED BY THE DEPARTMENT, WERE PERSONAL SERVICES RENDERED WITHIN THE MEANING OF SECTION 107(a) OF THE INTERNAL REVENUE CODE. SUCH SERVICES COVERED A PERIOD LONGER THAN THIRTY-SIX (36) MONTHS; THEREFORE, APPELLANTS IN REPORTING THE AWARD OF $68,837.96 ON THEIR 1952 JOINT INCOME TAX RETURN, PROPERLY ALLOCATED THE SAME OVER A PERIOD DURING WHICH THE SERVICES WERE RENDERED, AND THEY ARE ENTITLED TO THE BENEFITS OF SAID SECTION 107(a).

It is admitted that husband's first trip to the Internal Revenue Department in the early part of 1944 was for the purpose of obtaining advice, how to protect himself against possible involvement in future tax fraud charges to be brought against his employer. Whatever the husband's motivation might have been in seeking the advice, the information disclosed was used by the Internal Revenue Department for tax collection purposes. In any case, the advice given by the Internal Revenue Department through Boland resulted in husband's continued work, beginning in

March 1944, to copy the fraudulent records. Of course, it is to be assumed that the Internal Revenue Department is not interested in pursuing a person who is innocent of the tax fraud of his employer and, therefore, the advice as to the keeping of the records. However, the primary purpose of the Internal Revenue Department is to collect all taxes justly due to the Government and, therefore, as far as the Department was concerned the keeping of the records, beginning with March 1944, served one purpose and that is to collect additional taxes if those records prove the taxes are due.

Internal Revenue Agent Shurlock reported on May 11, 1950, that "the information supplied by the informer" (that is husband) "was of good value in the investigation, generally speaking, it was specific, based on facts and conveying details and resulted in large adjustment to taxable net income." (Tr. 101.)

It is apparent from the whole of the record that the husband first supplied information to the Internal Revenue Department not later than March 1944. (Tr. 48, 49.) It is admitted that the first information was not nearly complete enough to base thereon an audit of the books of the fraudulent taxpayer; in fact, the information supplied was not complete even in February 1947 when the husband visited the Internal Revenue Department the second time giving the information to Deputy Collector Boland. (Tr. 43, 54.) Even though the husband, following the advice received from the Internal Revenue Department in February or March 1944, began preparing his record copies and

continued doing so during the remaining months of 1944, during the year of 1945 and 1946 these records were still not sufficient, because in February 1947 Deputy Collector Boland told him that a great deal more information was going to be needed than that supplied at that visit. (Tr. 59.)

The first written information was supplied by husband to the Department in the form of typewritten brief allegations. (Tr. 91.) Additional brief allegations were supplied between April and July 1947. (Tr. 91.) The detailed information was supplied by husband to support the allegations to Agent Shurlock during the summer of 1947 until the fall of that year when the two of them went through the various allegations. (Tr. 91.)

Section 107(a) of the Internal Revenue Code is the one that petitioners attempt to invoke with reference to their 1952 tax return and particularly with reference to the informer's award received by the husband in that year in the amount of $68,837.96.

We understand that the burden is upon petitioners to show that they come within the coverage of the above section. (*Van Hook v. United States,* 204 Fed. 2d 25.) They submit that the record made by their witness shows that they carried the burden successfully and have shown that Section 107(a) is applicable for a period of not less than forty-three months. Section 107(a) is a remedial one, and all remedial statutes should be liberally construed to give effect to the underlying principle. (See *Sovik v. Shaughnessy,* 92 Fed. Supp. 202.) The petitioners, as the record dis-

closes, have shown compliance with the requirements of Section 107(a) and respondent, therefore, is authorized and directed to extend the benefits of said section to the award received by them in 1952. Having shown that the requirements are complied with, it is the duty of respondent to apply this section, the purpose of which is to mitigate against this harshness, when the amount to be taxed was earned with the efforts of a great many years, in this case over a period of not less than forty-three months.

It is respectfully submitted that notwithstanding the fact that the first information was supplied by petitioners to the Internal Revenue Department in February or March 1944 for the purpose of protecting the husband against any possible future charges of tax fraud complicity, the information was used by the Internal Revenue Department to recover additional taxes from the fraudulent taxpayer. Such use of the information is the basis underlying the consideration under Section 107(a) of the Internal Revenue Code and, therefore, petitioners are entitled to the benefit thereof.

III.

APPELLANT HUSBAND WHO INFORMED THE INTERNAL REVENUE SERVICE AS TO THE ALLEGED IRREGULARITIES ON THE BOOKS OF A TAXPAYER, WAS INSTRUCTED BY SAID SERVICE TO PROCEED WITH THE GATHERING OF DETAILED INFORMATION AS TO SUCH ALLEGED IRREGULARITIES AND COMPLIED WITH THE INSTRUCTIONS. THE PERIOD, WHICH WAS EXPENDED BY HIM IN GATHERING SUCH INFORMATION AS INSTRUCTED, IS INCLUDABLE IN THE PERIOD DURING WHICH PERSONAL SERVICES WERE RENDERED BY APPELLANT HUSBAND TO THE INTERNAL REVENUE SERVICE IN ACCORDANCE WITH SECTION 107(a) OF THE INTERNAL REVENUE CODE OF 1939.

To persuade his employer R. E. Myers that he ought not to keep fraudulent records, not only because his company was making enough money without cheating, but particularly because by such procedure he likely exposed himself to future tax fraud charges (Tr. 46), husband threatened to quit his employment unless the fraudulent bookkeeping ceased; however, his employer sloughed off the objections by stating that the husband had nothing to do with the books nor with the tax work, such work was done by a public accountant. (Tr. 46.)

The continued fraudulent bookkeeping made the husband worry on his own account, too. He feared that future tax fraud charges may involve him, too. (Tr. 48.) In 1944 the husband went to San Francisco and phoned to the Internal Revenue Service for an appointment. He saw an employee of the Revenue Service who very likely was Mr. Boland. (Tr. 48 and 74.) The husband told about his worry concerning his employer's fraudulent tax bookkeeping and wanted to know what he should do to protect himself

against possible future charges of fraud complicity. He was told that he should make records of the false entries and keep that as evidence. He began to keep such records in February or March 1944. The work involved in the keeping of the records was always late at night on his own time, either at home or at the office. The keeping of the false bookkeeping entries were continued to be made during the whole year of 1945 and of 1946. The copies were kept at home in a safe. (Tr. 48-49.)

The above testimony is uncontradicted, and therefrom it appears that the Department received information from husband as to the alleged fraud of a taxpayer. Husband was instructed to keep records, which he did, beginning with February or March 1944. In about March 1946 husband was fired from his job.

In February 1947 he turned over to the Internal Revenue Department some forty-five specifications as to the taxpayer's fraud. (Tr. 71, 78 and 79.) The forty-five allegations outlined briefly the fraud charged. (Tr. 78.) The Internal Revenue Service began an audit of the taxpayer's books in May 1947 and the agents for the Department were in contact with the husband all through the summer of 1947 until about the fall of that year. One agent got in touch with the husband quite often in connection with the various allegations and they went through them. (Tr. 78, 80.) Additional allegations were supplied by the husband in June 1947. (Tr. 80.)

Husband offered to the Internal Revenue Service the first information of the alleged fraud of the tax-

payer in February or in March 1944; pursuant to the recommendations made to him by the Service, prepared copies of the false bookkeeping records during the last ten months of 1944, during the twelve months of 1945 and the first two months of 1946, for a period of twenty-four months. He kept these records during the remainder of 1946, that is, for ten months and the first two months of 1947, that is for another additional twelve months, when on or before February 22, 1947, on the basis of the copies of the records kept by him, he turned over to the Service some forty-five short allegations of the tax fraud. (Tr. 48, 49, 53, 59 to 63, 65, 66, 71 to 74, 79.)

Respondent contends that the thirty-six months which transpired between husband's first giving information to Revenue Service in February or March 1944 until February 22, 1947, when he supplied the allegations, are to be left without consideration because such preliminary work is not part of the time spent on personal services. As we understand, respondent bases its argument on the assumption that since the husband obtained suggestions from the Internal Revenue Service as to the keeping of the records to protect himself against possible charges, the Service itself was not interested in the possible tax fraud at all. Such an assumption is not conceivable to us, but rather assume that Mr. Boland, Deputy Collector in San Francisco (or whosoever the person may have been that husband talked to in the early part of 1944) was well aware of his duty and having obtained information of possible substantial tax fraud proceeded

on such information pursuant to law that made it incumbent upon the Revenue Service to collect taxes when such taxes were due.

The thirty-six months during which husband made copies are part of the period during which he performed personal services for the Treasury Department.

The Court so held in *Smart v. Commissioner,* 152 Fed. 2d 333.

In that case the question involved was the commission earned by a trustee. After the trustee succeeded in satisfying the Court upon an accounting as to his stewardship, it was held by the Court that it is natural to think of what he then receives as having been earned progressively.

In the instant case, the record discloses that the husband informed the Revenue Service in February or March 1944 as to the tax fraud of a taxpayer. He was told to keep records, which he did, during the subsequent twenty-four months, that is, until March 1946. For the next twelve months he prepared a summary of the copies kept by him of the false records, and such summary he turned over in the form of allegations to the Revenue Service on or before February 22, 1947. Those thirty-six months are to be considered part of the period of personal services rendered, and the award received by him from the Treasury Department in 1952 is to be considered "as having been earned progressively" during a period that includes the thirty-six months of preparatory work.

After February 1947 husband worked with the agents of the Revenue Service at least until September 1947, for another seven months, so the minimum period during which husband's personal services were rendered covers forty-three months. The award of $68,837.96, therefore, is taxable pursuant to Section 107(a). The contrary holding of the Tax Court is in error, and it ought to be reversed.

IV.

APPELLANT HUSBAND, HAVING SUPPLIED TO THE INTERNAL REVENUE SERVICE THE INFORMATION GATHERED BY HIM CONCERNING THE ALLEGED IRREGULARITES ON THE PART OF A CERTAIN TAXPAYER, WAS INSTRUCTED BY SAID SERVICE TO CONTINUE TO SUPPLY TO IT EXPLANATIONS AND CLARIFICATIONS OF THE INFORMATION SUPPLIED, WHICH APPELLANT HUSBAND DID. THE PERIOD OF TIME DURING WHICH APPELLANT HUSBAND WAS READY, WILLING AND DID SUPPLY SUCH CLARIFICATION AND EXPLANATION TO THE INTERNAL REVENUE SERVICE IS CONSIDERED PART OF THE PERIOD UNDER SECTION 107(a), DURING WHICH PERSONAL SERVICES WERE RENDERED.

The previous subdivisions I to III presented only such evidence that remained uncontradicted on the record. On the basis of such uncontradicted testimony it was argued that the award of $68,837.96 is taxable pursuant to Section 107(a) as payment for services rendered over a period of forty-three months.

Now, we shall propose to show that even on the basis of testimony that is contradicted on the records that the personal services rendered extended over a

period of more than seventy months, and not less than sixty-one months.

The wife testified that Revenue Agents visited petitioners' home to obtain information concerning the tax fraud during the years 1947, 1948 and 1949. (Tr. 59 to 61.) Wife also testified that John Boland, Deputy Collector, Internal Revenue Department in San Francisco, called husband to San Francisco in 1950; that both of them went to see Boland during which time husband was asked for additional information. (Tr. 63.) The wife testified about a letter written by Mr. Parsons, Assistant Secretary of the Treasury in Washington, to the husband. This letter (Exhibit 3, Tr. 92, 93) which is dated September 19, 1951, informed the husband that his claim for the award "is receiving active consideration; however, it has been found necessary to request additional information from the Field Office in California and your case cannot be concluded until that information is received at Headquarters."

If wife's above testimony would have remained uncontradicted, it is submitted that the period of services rendered by the husband for which the award was given to him would have extended from March 1944 to at least September 10, 1951, that is, over a period of seventy-nine months. The wife's testimony with reference to personal services rendered by the husband after September 1947 is contradicted by Revenue Agent Shurlock. Considering the whole of the testimony of the government's witness, the same must be considered so unsubstantial that it will not support

the findings of fact of the Tax Court. We submit, further, that the government's witness's testimony is so incredible that the whole of it must be disregarded and, therefore, the findings of fact ought to be set aside by this Court because the same are clearly erroneous. *Johns v. C.I.R.,* 180 F. 2d 469; *Cronin's Estate v. C.I.R.,* C.C.A. 6, 1947, 164 F. 2d 561; *Tennessee Consol. Coal Co. v. C.I.R.,* C.C.A. 6, 1944, 145 F. 2d 631; *Lawton v. C.I.R.,* C.C.A. 6, 1947, 164 F. 2d 380. See, also, *Kent v. C.I.R.,* C.A. 6, 1948, 170 F. 2d 131.

Agent Shurlock recalls, at least on direct testimony, that husband worked with him quite often in connection with the various allegations as to the fraud until about the fall of 1947. (Tr. 83.) He also recalls that he discussed the case with husband about September 1947. (Tr. 79, 82.) This Agent saw husband after September 1947 but such get together was as personal friends. (Tr. 82.) When Agent Shurlock got together with husband in 1948 and 1949 they had conversations, and generally speaking the conversation was "When am I going to get my reward?" (Tr. 83.) During these later years there was quite a bit of reminiscing between the two about the tax matter. They would "discuss some of the issues involved" on which husband had furnished information. The two of them would discuss "and go over the points" which were brought out as to the tax fraud. (Tr. 83.)

On the face of such testimony, it is submitted that Agent Shurlock cannot be believed because it does not stand to reason that he would waste his time during the years of 1948 and 1949 to visit with the husband

if the conversation between the two of them was nothing more than generally speaking, "When am I going to get my reward." It is much more likely that the get together between the agent and the husband in the years of 1948 and 1949 was for the purpose testified to by the wife and affirmed by the agent when he said that he and the husband would *"discuss some of the issues involved."* (Tr. 83.) It is much more likely that Agent Shurlock was telling the truth when he testified that in 1948 and 1949, he and the husband would discuss and *"go over the points"* with reference to the tax fraud that was *"brought out."* (Tr. 83.)

Doubt is cast upon the truthfulness of Agent Shurlock, who on direct examination testified that the last discussion between him and the husband was in about September 1947 (Tr. 81, 82), while on cross-examination he **"can't be sure"** *that he never talked to husband about the fraud allegations from September 1947 to July 1948.* (Tr. 99.) While he cannot be sure as to the dates, he doesn't think that he talked to the husband about the fraud allegations in May 1948. He could have talked to him in October or November 1947. (Tr. 99.) Thus, Agent Shurlock's testimony on cross-examination as to the dates becomes less positive than it was on direct examination. Considering his obvious lack of candor in remembering important matters, his testimony becomes totally unreliable. He testified that he was the agent in charge of the audit of the fraud allegations against the taxpayer reported upon by husband; however, he doesn't remember the details concerning fraud assessment against the fraud-

ulent taxpayer. On that score he "would have to refresh my mind with looking at my report. *It is so long ago I would not remember what I recommended.*" (Tr. 96, 97.) In other words, Agent Shurlock is unable to recall the significant fact as to his recommendation for or against fraud assessment. He doesn't remember it because it was so long ago. On the other hand, he remembers that his conversation with husband as to the tax fraud records took place in September 1947. With such hazy memory, we believe that Agent Shurlock's testimony contradicting the testimony of the wife ought to be wholly disregarded.

Testimony of respondent's witness Shurlock ought to be disregarded for the further reason that the same is inherently improbable. The improbability appears on the basis of his own testimony.

Agent Shurlock testified that the audit of the books of the fraudulent taxpayer began in May of 1947. (Tr. 79.) Husband supplied an original list of about forty-five fraud allegations (Tr. 79) and, subsequently, he furnished additional allegations making a total of sixty-eight or seventy. (Tr. 79.) The allegations were typewritten "with no headings, just as a sort of brief outline of each of the, of the matter involved in each allegation." (Tr. 79.) Agent Shurlock saw husband and discussed the sixty-eight or seventy allegations "all through the summer of 1947 . . . to until about the fall of '47 I worked with him, I got in touch with him quite often in connection with, as we went through these various allegations." (Tr. 79, 80.)

If Agent Shurlock's testimony can be believed, he obtained all the information that the husband gathered from March 1944 to February 1947, and covering some sixty-eight or seventy tax allegations, during the short period of time from May to about September 1947, that is, in about three or four months. Agent Shurlock then worked on his final report that he submitted to his superiors in July 1948. (Tr. 80.) Even though he met husband between September 1947 and July 1948 and even in 1949, he never talked to him again about the tax matter. (Tr. 82, 83.)

The inherent improbability of Agent Shurlock's testimony is obvious. More so because the tax fraud case was not closed until "around 1950" (Tr. 81) and Agent Shurlock did not submit his own report concerning the value of the information supplied by husband until "about May 1950." (Tr. 84.) In this report Agent Shurlock evaluated the information supplied by the husband as follows: "The information furnished by the informer was of good value in the investigation. Generally speaking, it was specific, based on facts and conveying details which saved time in running down leads and resulted in large adjustments to taxable net income." (Tr. 101.)

The contradiction in Agent Shurlock's testimony stands out bold when we recall that he got the sixty-eight or seventy allegations from husband between April and May 1947. (Tr. 78, 79.) These allegations may have been supplied to him between April and July 1947. (Tr. 91.) In any case, the sixty-eight or seventy allegations were "just as a sort of brief

outline of each of the, of the matter involved in each allegation." (Tr. 79.) Agent Shurlock also testified that he "never received anything from him (the husband) any documentary evidence, further studies or copies of other documents made by him of the books and records of" the fraudulent taxpayer. (Tr. 101.) The question then arises how could the information supplied by husband be specific; how could it convey details as it was stated by the self same agent in his report of May 1950. (Tr. 101.) The further question arises and that pertains to the uncontradicted fact that the Internal Revenue Service suggested to the husband in February or March 1944 to prepare copies of the fraudulent book entries of the taxpayer charged. The uncontradicted testimony shows that such records were kept from that day on until at least March 1946. In face of the uncontradicted testimony, it is not believable that Agent Shurlock, in charge of the audit, would not have asked to see the documents which were copied, particularly when the amount of the additional taxes to be recovered was large, as his report of 1950 stated it to be. (Tr. 101.)

It is submitted that Agent Shurlock's testimony, contradicting the testimony of the wife cannot be believed and that her testimony ought to be accepted that personal services were rendered by husband during the years 1948, 1949 and 1950, and considering Exhibit 3, that is, the letter of Mr. Parsons of September 19, 1951, (Tr. 92, 93) it must be accepted that the personal services of husband covered the whole period from March 1944 to September 1951 for a total of seventy-nine months.

There is another piece of uncontradicted testimony, and that is the letter of husband to Wm. W. Parsons, Administrative Assistant Secretary, Treasury Department, Washington, D. C., which letter is dated November 9, 1951 and is marked as Petitioners' Exhibit 4. (Tr. 94, 95.) In this letter the husband writes to the Treasury Department that "I feel that I have done all in my power to cooperate with your various people that called upon me for additional information from time to time." There was no denial, nor was there contrary evidence presented by respondent that the husband in Exhibit 4 did not tell the truth. The record shows that he did cooperate with the various people of the Treasury Department who called upon him for additional information from time to time. The record is clear that husband was called to the Revenue Service by Assistant Collector Boland in 1950 and was asked for additional information. The evidence is uncontradicted, as is presented by Exhibit 3, that in September 1951 the Treasury Department needed additional information, and since the husband did cooperate and supplied additional information as he was called upon from time to time, the period of personal service extends up to September 1951, and Section 107(a) ought to be applied to the award received in 1952 covering a period of seventy-nine months.

V.

THE HOLDING OF THE TAX COURT THAT "AN INFORMER'S AWARD RECEIVED BY APPELLANT HUSBAND OF $68,837.96 DID NOT QUALIFY FOR TREATMENT UNDER SECTION 107(a), INTERNAL REVENUE CODE OF 1939, SINCE SERVICES LEADING TO AWARD DID NOT EXTEND OVER A 36-MONTH PERIOD" IS ERRONEOUS BECAUSE IT IS CONTRARY TO THE FACT.

The uncontradicted testimony shows that husband, as recommended to him by the Internal Revenue Service of San Francisco, began making copies of the fraudulent book entries of the company involved in February or March 1944. (Tr. 49.) Agent Shurlock, in charge of the audit, submitted his final report resulting in large additional taxes assessed against the fraudulent taxpayer in July 1948. (Tr. 99.) The husband at no time refused to supply information or make himself available for consultation to the agents, but to the contrary, he was always at the disposal of the Revenue Service. As the wife testified, the husband "gave them" (agents of the Revenue Service) "everything they asked for and everything they wanted." (Tr. 71.)

It is nothing but common sense to assume that the husband who was anxious to receive his award for the information; that the husband who was always asking Agent Shurlock in 1948 and 1949 "when am I going to get my reward" (Tr. 83) would cooperate with the agents to the fullest extent possible. The record discloses that he did so and that his personal services for which the award was given to him in 1952 extended over a period not less than from March 1944

to July 1948, that is, over a period of fifty-two months. Section 107(a) ought to be declared to be applicable to the award of $68,837.96 received in 1952 covering a period of not less than fifty-two months. Such a decision is in line with *Smart v. Commissioner,* 152 Fed. 2d 333, and also in accordance with the case of *D. G. Haley,* 16 U.S.T.C. 1462.

VI.

THE HOLDING OF THE TAX COURT THAT "AN INFORMER'S AWARD RECEIVED BY APPELLANT HUSBAND OF $68,837.96 DID NOT QUALIFY FOR TREATMENT UNDER SECTION 107(a), INTERNAL REVENUE CODE OF 1939, SINCE SERVICES LEADING TO AWARD DID NOT EXTEND OVER A 36-MONTH PERIOD" IS ERRONEOUS BECAUSE IT IS CONTRARY TO LAW.

This Court ought to review and reverse the Tax Court decision because that Court incorrectly applied the law which pertains to the issues involved in the instant controversy. *Hormel v. Helvering,* 60 S.Ct. 619, 312 U.S. 552; *R. P. Farnsworth & Co. v. C.I.R.,* C.A.La. 1953, 203 F. 2d 490; *C.I.R. v. Erie Forge Co.,* C.C.A. 3, 1948, 167 F. 2d 71.

It is submitted that in accordance with the testimony of Agent Shurlock the case of the fraudulent taxpayer was not closed until 1950. (Tr. 81.) On the basis of such testimony the period of personal services rendered by the husband to the Internal Revenue Service, for which services he received an award

of $68,837.96 in 1952, covered a period of approximately twenty months longer than we argued for in the previous Section V. The period of personal services rendered covers, therefore, approximately sixty-four months, and under all circumstances a period of sixty-one months, as it was set forth in petitioners' income tax return of 1952.

It is submitted that the period of sixty-one months used by petitioners in applying Section 107(a) on their 1952 income tax return to calculate the taxes due on the award of $68,837.96, is fully justified in *Smart v. Commissioner,* 152 Fed. 2d 333; *D. G. Haley,* 16 U.S.T.C. 1462; *Guy C. Myers,* 11 U.S.T.C. 447; *Harry L. Addison,* 3 U.S.T.C. 427, and *Herbert Stein,* 14 U.S.T.C. 494, which cases were hereinabove discussed.

It is submitted that petitioners' claim that the amount of tax payable on the award of $68,837.96 be calculated with the benefit of Section 107(a) of the Internal Revenue Code, is more than reasonable because it covers only the actual period during which the husband was ready, willing and able and did perform personal services for which he received the award. The sixty-one months excludes the time during which he negotiated the settlement of his claim. Such period, which was needed to establish his claim to the award, was held as includable in the period of service to be considered in applying Section 107(a).

In the case of *John W. Love v. United States,* 85 F. Supp. 62, it was held that payment upon termina-

tion of services, the period of establishing claim of a corporation is included in the period of service.

In the case of *Federico Stallforth,* 6 U.S.T.C. 140, it was held as in the *Love* case (supra) that the period used to make settlement extended the period of claim.

Because of the above holdings, it is respectfully submitted that the period used by petitioners in their 1952 income tax return, that is, sixty-one months during which the benefits of Section 107(a) applies, is more than reasonable and justified under the law applicable hereto. It is submitted that this Court so holds and, therefore, the contrary holding of the Tax Court ought to be reversed.

CONCLUSION.

Petitioners submit that the award of $68,837.96 received by husband in 1952 was for personal services rendered. They submit that such personal services covered the period beginning with March 1944 and extended to September 1951, that is for over a period of seventy-nine months, or longer. The period of personal services are to be considered in law and in good conscience and on the basis of the facts, to extend up to the time when the award was received in April 1952, that is, over an additional period of seven months, making a total of eighty-six months. In any case, the personal services cannot be held to cover

less than sixty-one months as applied to the tax calculation by petitioners on their 1952 tax return which includes the award received in the amount of $68,837.96.

Respondent in compliance with the provisions of Section 3792 of the Internal Revenue Code of 1939, deemed it lawful and proper to pay to husband the sum of $68,837.96. The payment was as "reward for information leading to the detection and punishment of persons violating Internal Revenue laws". (Treasury Decision 5379—C. B. 1944, 479.)

Husband in filing his claim for reward (Form 211) on February 22, 1947 (Tr. 56) did so pursuant to the above Treasury Decision 5379. The whole of the record discloses that the payment to him was for services rendered and that such services were rendered by him personally. The services *necessarily* rendered were performed during a period substantially in excess of thirty-six months. To hold, as the Tax Court did, that "petitioners have not established that Faul (husband) performed services for the Bureau of Internal Revenue over a 36-month period" (Tr. 32, 33) is *clearly* contrary to the facts. The holding that petitioners "may not claim the benefit of Section 107(a)" (Tr. 33) is clearly contrary to the law applicable to the facts.

The Tax Court clearly misapplied the law in this case. Its findings of fact are clearly erroneous in that they are not supported by any evidence and not even

by substantial evidence, therefore, the decision of the Tax Court ought to be reversed.

Dated, Carmel, California,
June 24, 1958.

Respectfully submitted,
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(Appendix Follows.)

Appendix.

Appendix

TABLE OF EXHIBITS RECEIVED IN TRANSCRIPT OF RECORD*

Petitioners' Exhibit "A"—Notice of deficiency ..... Tr. 11

Petitioners'-Respondent's Joint Exhibit "1-A" (photocopy). Tr. 56-57

Petitioners' Exhibit "2"—Received but to be furnished .... Tr. 64

Respondent's Exhibit "C"—Letter, Elmer Faul to Boland.. Tr. 86

Respondent's Exhibit "D"—Letter, Elmer Faul to Parsons.. Tr. 88

Respondent's Exhibit "E"—Letter, Elmer Faul to Commissioner of Internal Revenue ..... Tr. 90

Petitioners' Exhibit "3"—Letter, Parsons to Elmer Faul ... Tr. 92

Petitioners' Exhibit "4"—Letter, Elmer Faul to Parsons ... Tr. 95

*Table in accordance with Rule 18.2(f), Rules for the United States Court of Appeals (9th Circuit) as amended Aug. 21, 1957.

No. 15987

In the United States Court of Appeals for the Ninth Circuit

ELMER J. FAUL AND SYBELL E. FAUL, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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In the United States Court of Appeals for the Ninth Circuit

No. 15987

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COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

---

BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 23-33) are reported at 29 T.C. 450.

JURISDICTION

This petition for review (R. 103-106) involves federal income taxes for the taxable year 1952. On December 6, 1954, the Commissioner of Internal Revenue mailed to the taxpayers notice of a deficiency in the total amount of $18,350.23. (R. 11-15.) Within 90 days thereafter and on February 28, 1955, the taxpayers filed a petition with the Tax Court for a

redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code of 1939 (R. 3-15.) The decision of the Tax Court was entered December 16, 1957. (R. 33.) The case is brought to this Court by a petition for review filed March 11, 1958. (R. 103-106.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Is there clear error in the Tax Court's findings that taxpayer did not perform services as an informer which extended over a period of 36 months, and hence that he is not entitled to the income allocation benefits of Section 107(a) of the 1939 Code.[1]

STATUTES AND TREASURY DECISION INVOLVED

The statutes and Treasury Decision involved are set forth in the Appendix, *infra.*

STATEMENT

The facts as found by the Tax Court (R. 24-29), and partially stipulated by the parties (R. 20-23), are as follows:

---

[1] A second issue below was raised by the Commissioner's contention that taxpayers could not qualify for the benefits of Section 107(a) because the informer's award was not compensation for personal services within the meaning of the statute. The Tax Court did not reach this question since it sustained the Commissioner on the issue presented here. Should this Court disagree with the Tax Court's decision on its present basis, the Commissioner requests that the case be remanded for the Tax Court's consideration and ruling upon the Commissioner's second contention.

Taxpayers Elmer J. Faul and Sybell E. Faul, formerly husband and wife, were divorced after the filing of the petition in this case. Elmer J. Faul (hereinafter referred to as Faul) now resides in San Francisco, California. Sybell E. Faul (hereinafter referred to as Sybell) resides in Carmel, California. Taxpayers filed their joint income tax return for the year 1952 with the District Director of Internal Revenue, San Francisco, California. (R. 24.)

From approximately February, 1941, to March, 1946, Faul was employed full-time as office manager by the R. E. Meyers Company of Salinas, Monterey County, California. The R. E. Meyers Company was a subsidiary of the Salinas Valley Ice Company (also known as Salinas Ice Company, Ltd.) of Salinas, Monterey County, California. (R. 24.)

Following 1942, Faul asked his employer, Ralph Meyers, why he was cheating with his books and exposing himself to a charge of fraud. Faul further said that he did not wish to remain with Meyers and continue to be exposed to such conduct. Meyers regarded the objections lightly and assured Faul that he would "have someone else do it". At that time he hired Emmett Gottenburg, a certified public accountant, to keep the tax records and prepare the tax returns for the above-named companies. (R. 25.)

In 1944, Faul went to San Francisco to talk to "some Government man" about what he would do to protect himself. Faul was told that he should make records and have evidence so that he would not be exposed. (R. 25.)

In order to shield himself Faul, working in his

home and in the office late at night, commenced to compile records in February or March of 1944. He continued with this record making for the remainder of 1944 and during 1945 and part of 1946. (R. 25.)

Faul was discharged by the Meyers Company in March, 1946. Thereafter he determined to submit evidence of the alleged fraud to the Government and on February 22, 1947, he had an interview in San Francisco with John Boland, Chief Field Deputy in the office of the Collector of Internal Revenue, San Francisco, California. At that time he submitted to Boland a memorandum of 45 alleged violations of the internal revenue laws by the Salinas Valley Ice Company. On the same day Faul filed a claim for reward on a Form 211. Additional information supplied by Faul between April and July of 1947 increased the allegations to a total of about 68 or 70. (R. 25-26.)

An Internal Revenue agent, Alan Russell Shurlock, commenced an audit of the Salinas Valley Ice Company in May, 1947. He was in contact with Faul concerning the list of allegations during the summer and fall of 1947. The last discussion between Shurlock and Faul for the purpose of enabling Shurlock to understand the allegations took place in September, October and November, 1947. He submitted his final report on the Salinas Valley Ice Company in July, 1948. The case was then forwarded to the conference section in San Francisco. Shurlock discussed the case with a conferee a number of times. To the best of Shurlock's knowledge Faul never met nor had a conference with the conferee. (R. 26.)

Shurlock, requested by his superiors to assess the value of the information furnished by Faul, reported that the information furnished by the informer was of good value in the investigation. In so doing he had in mind only the 68 allegations. He never received from Faul any documentary evidence, further studies, or copies of documents made by Faul of the books and records of the Salinas Valley Ice Company or the R. E. Meyers Company. (R. 26.)

Shurlock saw Faul during 1948 and 1949, usually at Faul's home. Mrs. Shurlock sometimes accompanied him. When Mrs. Shurlock came they did not all sit together. She played the piano and Shurlock stayed with Faul, not always in the same room. (R. 26-27.) Conversations between Faul and Shurlock were limited to the Government case. The general tenor of these conversations was "When am I going to get my reward?" Often they would reminisce about some of the issues involved concerning which Faul had furnished information and go over the points that had been brought out. On these occasions Faul furnished Shurlock no additional information in connection with the case. (R. 27.)

Shurlock visited Faul at least once during 1950 and 1951. Sybell was present during such a visit when a conversation concerning the fraud penalty against the Meyers Company took place. She could not recall whether Shurlock at that time asked Faul to supply any additional information. (R. 27.)

In May, 1950, Faul was called to San Francisco by Chief Field Deputy Boland. Sybell accompanied Faul to Boland's apartment. When asked on direct ex-

amination if Boland requested any additional information from Faul, Sybell replied, "Well, yes; my husband went into the kitchen * * * and really nothing much took place, because they were talking in the kitchen for a short time and then they came out and we left." Sybell and Faul never saw Boland except in connection with the case. (R. 27.)

During 1950 and 1951, Faul corresponded with officials in the Bureau of Internal Revenue and the Treasury Department concerning his claim for reward. In one such letter Faul stated, "Mr. O'Connell as his local representative Alan Shurlock conferred with me numerous times during first 2 years after I reported this case for information" (*sic*). (R. 27-28.)

On September 10, 1951, William W. Parsons, Administrative Assistant Secretary of the Treasury Department, wrote Faul, informing him that "it has been found necessary to request additional information from the field office in California and your case cannot be concluded until that information is received at headquarters." In April, 1952, Faul received a check in the amount of $68,837.96 as an informer's award. The award was paid from the appropriation for salaries and expenses, Bureau of Internal Revenue. (R. 28.)

The Collection Office of the Bureau of Internal Revenue demanded an estimated tax return and payment of estimated tax with respect to the $68,837.96. Payment of tax pursuant to such estimated tax return was made by the taxpayers in the amount of $25,825.82. (R. 28.) Thereafter taxpayers filed their

income tax return for the year 1952, and in connection with the award claimed the benefit of Section 107, Internal Revenue Code of 1939. Accordingly, the return indicated a tax liability of $17,150.02 and an overpayment of $8,825.46. This overpayment was refunded by the Bureau of Internal Revenue. Thereafter the Commissioner determined that the award received by Faul was not compensation for personal services covering a period of 36 calendar months or more within the meaning of Section 107 of the Internal Revenue Code of 1939, and further that the award was includible in full in gross income for 1952 in accordance with Section 22(a) of the Internal Revenue Code of 1939. The Commissioner determined a deficiency of $18,350.23. (R. 28-29.) The Tax Court sustained the Commissioner's determination. (R. 29-33.)

SUMMARY OF ARGUMENT

Under Section 107(a) of the 1939 Code taxpayers seek an income allocation over a period of years of an informer's award received by the taxpayer-husband in 1952. The statute allows such an allocation only where the income involved constitutes compensation for personal services covering a period of 36 months or more. The Tax Court found that taxpayers had failed to show that the services relating to the informer's award began any earlier than February, 1947, or concluded any later than the fall of the same year. This finding is amply warranted by the record. Hence taxpayers are not entitled to the allocation benefits of Section 107(a), and the decision of the Tax Court should be affirmed.

ARGUMENT

The Tax Court Was Amply Warranted By The Record In Finding That The Taxpayer-Husband's Services Relating To The Informer's Award Did Not Extend Over A Period Of 36 Months Or More; Therefore Taxpayers Are Not Entitled To The Income Allocation Benefits Of Section 107(a) Of The 1939 Code.

An informer's award was received in April, 1952, by taxpayer Faul from the Internal Revenue Service (R. 22) in settlement of his claim for reward under T. D. 5379 (Appendix, *infra*) based upon "information furnished by me"(R. 56). Taxpayers contend that the services relating to the award were rendered over a period of more than 36 months and that they are entitled to a corresponding allocation of the award under Section 107(a) of the Internal Revenue Code of 1939 (Appendix, *infra*).

The purpose of Section 107(a) is "to alleviate tax hardships resulting on long-term workers who receive compensation upon the completion of their services." *Lindstrom* v. *Commissioner*, 149 F. 2d 344, 346 (C. A. 9th). Section 107(a) permits taxpayers who qualify for this exceptional relief to figure their tax as if the compensation had been received ratably over the period of services before the time of receipt. To qualify for relief the taxpayers must prove that they received at least 80 percent of the total compensation for personal services in one taxable year, that the payment was compensation for personal services, and that these services were rendered for a period of 36 months or more from the beginning to the completion of such services. It is clear from the cases

which have interpreted Section 107(a) that it constitutes an exception to the general rule requiring annualization of income and that the taxpayers must come squarely within the letter and the spirit of the law if they are to derive the benefits thereof. *Lindstrom* v. *Commissioner, supra; Van Hook* v. *United States,* 204 F. 2d 25 (C. A. 7th), certiorari denied, 346 U. S. 825; *Sloane* v. *Commissioner,* 188 F. 2d 254 (C. A. 6th); *Smart* v. *Commissioner,* 152 F. 2d 333 (C. A. 2d), certiorari denied, 327 U. S. 804. In *Van Hook* v. *United States, supra,* the Seventh Circuit stated (p. 28):

> The general statutory principle is that a taxpayer on a cash basis must report his income for the year when it is received. Section 107 is a special exemption from that principle. A taxpayer who claims the benefit of that section must show that he comes squarely within the letter and spirit of the Congressional grant.

The Tax Court found that taxpayers have not sustained this burden. (R. 30.) The Tax Court specifically found that taxpayers had not established that Faul performed services for the Bureau of Internal Revenue over the minimum 36 month period, thereby foreclosing their claim for the benefit of Section 107-(a). (R. 32-33.)

It is a well established principle that Tax Court findings will not be disturbed upon review except when clearly erroneous; here, it is submitted, the record fully sustains them. The Tax Court below based its conclusions and findings in part upon its appraisal of the credibility of the wittnesses, includ-

ing one of the taxpayers who testified before it. Upon review due regard is given to this opportunity of the trial court to appraise the credibility of witnesses in front of it, and the reviewing court will not disturb a Tax Court's finding or conclusion unless on the entire evidence it is left with a definite, firm conviction that a mistake has been made. *United States*, v. *Gypsum Co.*, 333 U.S. 364, rehearing denied, 333 U.S. 869; *Baumgardner* v. *Commissioner*, 251 F. 2d 311, 313 (C. A. 9th); *Ferrando* v. *United States*, 245 F. 2d 582, 587-588 (C.A. 9th); *Wener* v. *Commissioner*, 242 F. 2d 938, 944 (C. A. 9th); *Ward* v. *Commissioner*, 244 F. 2d 547, 549-550 (C. A. 9th); *National Brass Works, Inc.* v. *Commissioner*, 205 F. 2d 104, 106-107 (C. A. 9th); Rule 52(a), Federal Rules of Civil Procedure; Section 7482(a) of the Internal Revenue Code of 1954 (formerly Section 1141(a) of the 1939 Code).

A review of the record demonstrates that the findings and conclusions of the Tax Court are not only not clearly erroneous, but are, in fact, completely supported by the record. Taxpayer Faul first began to work for his employer in 1941. (R. 45.) By 1942 Faul became alarmed about the tax practices of his employer and the possibility of Faul's exposure to fraud. Faul complained of it to the employer in 1942 and 1943. The employer assured Faul that he would not have to do it and hired another man, Emmett Gothenburg, to take over. (R. 46.) Faul continued to worry about exposing *himself* to possible tax fraud charges. (R. 48.) As a result in 1944, Faul

went to San Francisco to talk to "some Government man" for the sole purpose of determining what he might do to protect himself against possible future charges. (R. 48, 74-75.) Faul was advised to make records in order to protect himself. (R. 48.)

Beginning with this 1944 visit, the taxpayers contend that Faul was rendering services to the Internal Revenue Service by a supposed supplying of information in that year and the subsequent gathering of information from that time to September, 1947. (Brf. 20-35, Points I, II, III.) Taxpayers make the unsubstantiated assertion that Faul furnished information to the Internal Revenue Service in 1944. (Br. 27, 30, 32.) Although admitting that Faul's 1944 visit was for the purpose of obtaining advice in regard to protecting himself against possible future involvement (B. 21, 27), taxpayers claim whatever the motivation "* * * the information disclosed was used by the Internal Revenue Department for tax collection purposes". (Br. 27; see also, Br. 30, 32). Apparently reliance is placed upon the testimony of taxpayer Sybell (R. 48, 49) for the conjecture that Faul first supplied information to the Internal Revenue Service not later than March, 1944. (Br. 28). A reading of these pages negatives this conjecture. Sybell merely stated that Faul came to San Francisco "to talk to some Government man" in regard to "what he should do to protect himself". (R. 48.) There is no evidence whatsoever in the record as to the identity of this Government man or that he and Faul conferred on any subject other than how Faul might protect himself.

The instant case is substantially similar to *Barker* v. *Shaughnessy* (N.D. N.Y), decided December 3, 1954 (48 A.F.T.R. 1301). The taxpayer informer, Barker, was tax counsel for a corporation. In November, 1942, Barker, using a fictional name, discussed a hypothetical case with the Internal Revenue Service based upon tax irregularities of an unnamed corporation, and inquired as to payment of an informer's award. Barker terminated his employment in February, 1943, and in March, 1943, disclosed his correct identity to the Internal Revenue Service, gave the name of the employer corporation and a list of alleged violations. A revenue agent commenced an investigation in April, 1943, and Barker was consulted until July, 1944, at which time he signed a Form 211 claiming a reward for information furnished on March 3, 1943, and subsequent dates. The investigation was terminated on August 11, 1944, and the case was closed about two years thereafter. Barker died in October 1944, and $75,000 was paid as an informer's award to his widow as executrix of Barker's estate. An attempt was made to claim the benefit of Section 107(a) in regard to this informer's award. The District Court disregarded the initial visit in computing the 36 month requirement of Section 107, and held that the first disclosure of information occurred in 1943, and the requirement would have to be computed from that date. The District Court found that there was no proof that Barker was performing services for the Internal Revenue Service prior to the latter date. The District Court further

stated that the informer, Barker, was being paid only for information and not for investigative efforts.

Taxpayers herein attempt to link the 1944 visit with the subsequent 1947 visit to the Internal Revenue Service (at which time Faul first submitted a memorandum of alleged violations to John Boland of the Internal Revenue Service (R. 21)) by the device of identifying the Government man in 1944 as Boland. Initially taxpayers say Faul "may have seen a Mr. Boland." (Br. 21.) Then the taxpayers actually make the flat statement that Faul consulted "with Boland" in 1944. (Br. 24.) Taxpayers also claim that the advice to prepare self-protective records was given "through Boland". (Br. 27-28.) Taxpayers subsequently exercise more caution and state that Faul saw an employee of the Internal Revenue Service "who very likely was Mr. Boland". (Br. 31.) Finally taxpayers make reference to "Mr. Boland, Deputy Collector in San Francisco (or whosoever the person may have been that husband talked to in the early part of 1944)". (Br. 33.) Taxpayers find support for these statements at pages 48 and 74 of the record. (Br. 24, 31.) The lack of support in the "some Government man" reference has been discussed above, and is obvious from the latter reference, which must be to the following comments of Sybell (R. 74):

> Q. With whom did he speak?
> A. I don't know, because I wasn't with him. He came here, and I thought it was Mr. Boland at the time. Was Mr. Boland with the Internal Revenue?

Every indication in the record is that neither information nor services were given to the Internal Revenue Service in 1944. Nothing in the record even suggests that Faul identified himself or his employer or the locale where he lived. (R. 48, 74.) Undoubtedly, Faul, as did the taxpayer informer in *Barker* v. *Shaughnessy, supra,* merely asked for advice while remaining anonymous. Otherwise the Internal Revenue Service would have made a record of the visit and promptly assigned a revenue agent to investigate the employer. It is also likely that Faul would have filed his claim for reward on Form 211 in 1944 if he had given information at that time. In addition, Sybell testified that Faul did not inform on the company until after he was fired (R. 71) in 1946 (R. 20, 50-51). Finally, Faul's own statements on this point are conclusive. In writing to the Commissioner of Internal Revenue on March 27, 1950, he said, "At the time I reported this case originally to Mr. Boland, I signed a paper protecting me for claim when the matter was thoroughly investigated and settled". (R. 90.) Faul reported the case to Boland and signed and filed Form 211 Claim for Reward on February 22, 1947. (R. 21.) If Faul had given information in 1944, he surely would have claimed 1944 as the date of supplying information when he actually filed the Form 211. Yet, by his own sworn statement, Faul claimed a reward for information furnished on the 22nd day of February, 1947. (R. 56.) In regard to a similar sworn claim for reward, the District Court in *Barker* v. *Shaughnessy, supra,* p. 1303, stated that such a statement "on its face would seem to be

decisive of the dates within which the services were performed since it was upon this claim that the reward was paid."

Preliminary work performed prior to actual contact with the person for whom the services were rendered has not been recognized in computing the time during which personal services were rendered within the meaning of Section 107(a). *Barker* v. *Shaughnessy, supra; Myers* v. *Commissioner*, 11 T. C. 447. Cf. *DeMarco* v. *Commissioner*, 9 T.C. 1188. Specifically, the period of investigative efforts producing a tax informer's information may not be included in the 36-month minimum requirement of Section 107 (a). *Barker* v. *Shaughnessy, supra.*[2]

Furthermore, in assessing the information furnished by Faul as of good value in the investigation, Shurlock unequivocally stated (R. 101) that he had in mind only the 68 allegations received from Faul on and subsequent to February 22, 1947 (R. 21, 79). Shurlock, who certainly knew what Faul had turned over to him, testified (R. 101) and the Tax Court so found (R. 26) that Shurlock *never* received from

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[2] Contrary to taxpayers' contention (Br. 34), the time prior to the initial disclosure in 1947 can not be considered part of the time requirement on the authority of *Smart* v. *Commissioner, supra,* for the court did not so hold. As the Tax Court noted (R. 32), taxpayers rely upon *dicta* in that case but even the *dicta* does not support taxpayers. The court merely said it was natural to think that a trustee, who had been properly appointed as trustee and who had performed as such, was earning his commission progressively even though he does not "earn" it until he had accounted to the court.

Faul any documentary evidence, further studies, or copies of other documents made by him of books and records of the Salinas Valley Ice Company or the R. E. Meyers Company.

In summary to this point, Faul's 24 months of record keeping and the next 12 months during which "he prepared a summary of the copies kept by him of the false records" (Br. 34) can not be included in computing the minimum requirement, and Faul did not render personal services to the Treasury Department for 43 months from March, 1944, through September, 1947, as claimed. (Br. 20-35, Points I, II, III.) The Tax Court properly found that taxpayers had not shown that Faul rendered any service to the Bureau of Internal Revenue before February 22, 1947. (R. 31.)

Inasmuch as the taxpayers have failed to establish the above finding as clearly erroneous, February 22, 1947, becomes a focal point for the computation of time. On February 22, 1947, Faul first supplied information to the Bureau of Internal Revenue and additionally filed the claim for reward for information furnished by him on that day. (R. 21, 56.) Therefore, assuming that Faul was thereafter rendering personal services, taxpayers must prove that these services continued until February, 1950. However, the record discloses that Faul's services were not rendered to February, 1950.

Beginning in March, 1947, Faul was interviewed by Internal Revenue Agent Allen Shurlock and other agents to whom he gave a memorandum of alleged violations by the Salinas Valley Ice Company. (R.

21.) It is not questioned that Shurlock conferred with Faul in connection with the list of allegations until the fall of 1947. (R. 79, 81-82, 83.)

But taxpayers claim that Faul continued to furnish information to the Internal Revenue Service during 1948, 1949, and 1950. (Br. 36.) This contention is based upon the self-serving testimony of taxpayer Sybell (R. 60-61) which, complain taxpayers, was contradicted by Shurlock as to the services allegedly rendered after September, 1947 (Br. 36). It should be noted that the Tax Court, able to appraise the credibility of both witnesses, found that the record established as a fact that Faul supplied no information subsequent to the fall of 1947. (R. 31.) Furthermore, as is obvious from the record references of taxpayers, the conclusions of Sybell, who was not a participant in the conversations or meetings, certainly were not entitled to much weight. Her testimony shows that she knew only in a general way that the men were talking about some phase of either the Salinas Valley Ice Company or the efforts of her husband to obtain a reward. (R. 59-61.) Furthermore, Sybell's memory was hazy in regard to the facts about which she did testify. She testified that Faul received a letter from Mr. Parsons, Assistant Secretary of the Treasury, in the fall of 1950 (R. 63) and that after receipt of the letter, Shurlock visited their home in Carmel in 1950 (R. 64), whereas the record shows that the letter from Parsons is dated September 10, 1951 (Ex. 3, R. 92-93). Although Sybell was present at one conversation between Faul and Shurlock in 1950 or 1951, she could

not remember whether Shurlock asked for additional information. (R. 65-66.)

On the other hand, Shurlock testified that he neither sought nor obtained information from Faul after November, 1947 (R. 81-82, 83, 91, 99), and that all discussions with Faul after that date took the form either of reminiscence about the former employer's fraud or a general discussion regarding Faul's claim for reward (R. 83). However, taxpayers attack Shurlock's truthfulness and reliability because of purported inconsistencies between testimony on direct and cross examination.[3] On cross examination taxpayers asked Shurlock if it was correct that he had "never" talked to Faul about the allegations from September, 1947, to July, 1948, at which time Shurlock filed his final report. Taxpayers seize upon the candor of Shurlock when he answered, "I can't be sure that I never talked to him about it." (R. 99.) Taxpayers then make much of the fact (Br. 38) that Shurlock said he may have talked to Faul in October or November, 1947 (R. 99). It should be noted that upon direct examination, Shurlock had testified that the last time he had discussed the Salinas Valley Ice Company case with Faul for the purpose of understanding the list of allegations

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[3] Taxpayers argue that Shurlock's testimony is not reliable because he was indecisive as to whether his report of July, 1948, contained a recommendation of fraud. (Br. 38-39.) On this point, the record shows that Shurlock's report involved three taxpayers and that it was not possible for the witness to be decisive because the questions were in general terms and did not distinguish or identify the different taxpayers. (R. 97-98.)

was "about September of 1947 * * *. That is within a month or so, but I am not sure." (R. 81-82.)

It is unquestioned that Shurlock submitted his final report on the alleged tax violations of the Salinas Valley Ice Company in July, 1948. (R. 80.) Up to that time, it is conceivable that an Internal Revenue Agent might have a need to review allegations or possible leads with an informer. Once the report was submitted, the case was transferred to a conferee in San Francisco (R. 80), and there is nothing in the record that indicates that Faul ever met or conferred with the conferee. Even assuming *arguendo*, that Faul had rendered personal services to the Bureau of Internal Revenue to the date of Shurlock's final report, only 17 months lapsed between February, 1947 and July, 1948.

There is an unexplained reference in Faul's letter of March 27, 1950, to the Commissioner that two Internal Revenue Agents "conferred with me numerous times during first 2 years after I reported this case for information." (R. 90.) Yet, even if we view this self-serving statement as meaning that these conferences were held for the purpose of giving information rather than the securing of a reward, taxpayers are not helped. Rather it is an admission by Faul that communication for Salinas Valley Ice Company purposes took place during a two year period, at the most. Such a time period would still lack twelve months necessary to meet the minimum requirement.

Apparently the Fauls and the Shurlocks became socially acquainted, and Shurlock testified that he

visited Faul in 1948 and 1949. During the course of these visits, Faul and Shurlock discussed various aspects of the case. (R. 82-83.) The tenor of the conversation was characterized by Shurlock (R. 83) as "When am I going to get my reward?" But Shurlock stated that these conversations were reminiscences and stressed that Faul was not furnishing him any information in connection with the tax violation case. (R. 82, 83.)

As explained above, taxpayers must establish the rendering of services to at least February, 1950, in order to meet the time requirement. Taxpayers seek to show a rendering of services during 1950 by referring to Sybell's testimony (R. 63) concerning a visit by both the Fauls to see Boland in May, 1950, during which time Faul supposedly was asked for "additional information" (Br. 36). When questioned whether Boland requested any additional information, Sybell replied (R. 62-63), "Well, yes; my husband went into the kitchen * * *. And really nothing much took place, because they were talking in the kitchen for a short time and then they came out and we left." There is no evidence as to what was said or that Sybell could even hear the conversation. Although Sybell testified that the Fauls never saw Boland except in regard to the case, the men more than likely were discussing the reward for which Faul was striving. Whether Faul gave Boland additional information about the tax violations of Salinas Valley Ice Company is certainly not established by this testimony. Furthermore, inasmuch as the case against Salinas was closed in early 1950 (R. 81), it

is unlikely that the Internal Revenue Service was still searching for leads.[4]

Taxpayers also claim that personal services were rendered to September 10, 1951, the date of a letter (R. 92-93) Faul received from Mr. Parsons, the Assistant Secretary of the Treasury (Br. 36, 41, 42). The letter informed Faul that "it has been found necessary to request additional information from the field office in California" and that Faul's case could not be concluded until that information was received at headquarters, (R. 92-93.) Firstly, the letter in plain terms states that it was necessary to request additional information from the California field office. As the Tax Court noted (R. 32), there is nothing to indicate that the information was expected from any source other than the field office, and there is no evidence that Faul supplied any other additional information. Secondly, from the terms of the letter, it is improbable that the information requested was related to the tax violations of the former employer, especially since that case was closed in 1950. (R. 81.) Rather, the tenor of the letter indicates a request for information from the field office regarding the merits of the reward sought by taxpayers. The

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[4] Taxpayers' suggestion that the time during which Faul negotiated the settlement of his claim should be includible in the period of service because it was so "held" (Br. 45) in *Love* v. *United States,* 85 F. Supp. 62 (E.D. Mo.), and *Stallforth* v. *Commissioner,* 6 T.C. 140, is based upon a misreading of both cases. The cited cases concern employee's attempts to secure Section 107(a) treatment of compensation for personal services rendered in connection with the settlement of claims for the respective employer.

mere fact that Faul had co-operated and had supplied information concerning the tax violations at a previous time (Br. 42) does not warrant a finding that he was rendering services up to the date the Treasury Department requested additional information, especially when every indication is that the information requested did not concern the tax violations.

In brief, the taxpayers have not established a rendering of services by Faul to the Bureau of Internal Revenue after the fall of 1947. Each of the taxpayers alternate contentions (Br. 44-46) as to various periods fails since each encompasses the time after the fall of 1947. The Tax Court's finding that the taxpayers failed to establish that Faul rendered services for the Bureau of Internal Revenue is not clearly erroneous but is fully supported by the record.

CONCLUSION

It is submitted that the decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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AUGUST, 1958

APPENDIX

Internal Revenue Code of 1939:

SEC. 107 [as added by Sec. 220(a), Revenue Act of 1939, c. 247, 53 Stat. 862, and amended by Sec. 139(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and by Sec. 119 of the Revenue Act of 1943, c. 63, 58 Stat. 21]. COMPENSATION FOR SERVICES RENDERED FOR A PERIOD OF THIRTY-SIX MONTHS OR MORE AND BACK PAY.

(a) *Personal Services.*—If at least 80 per centum of the total compensation for personal services covering a period of thirty-six calendar months or more (from the beginning to the completion of such services) is received or accrued in one taxable year by an individual or a partnership, the tax attributable to any part thereof which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such individual ratably over that part of the period which precedes the date of such receipt or accrual.

* * * *

(26 U.S.C. 1952 ed., Sec. 107.)

SEC. 3792. EXPENSES OF DETECTION AND PUNISHMENT OF FRAUDS.

The Commissioner, with the approval of the Secretary, is authorized to pay such sums, not exceeding in the aggregate the sum appropriated therefore, as he may deem necessary for detecting and bringing to trial and punishment persons guilty of violating the internal revenue

laws, or conniving at the same, in cases where such expenses are not otherwise provided for by law.

(26 U.S.C. 1952 ed., Sec. 3792.)

T. D. 5379, 1944 Cum. Bull. 479:

Under and by virtue of the provisions of section 3792 of the Internal Revenue Code * * * the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, does hereby offer for information that shall lead to the detection and punishment of persons guilty of violating the internal revenue laws, or conniving at the same, such reward as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall deem suitable, *but in no case exceeding 10 per cent* of the net amount of taxes, penalties, fines and forfeitures which, by reason of said information, shall be paid irrecoverably to the United States through suit or otherwise. Any person furnishing such information shall be eligible for reward under this Treasury decision unless he was an officer or employee of the Department of the Treasury at the time he came into possession of his information or at the time he divulged it.

The rewards hereby offered are limited in their aggregate to the sum appropriated therefor and shall be paid only in cases not otherwise provided for by law.

Claims for reward under the provisions hereof shall be made on Form 211, * * *.

U. S. GOVERNMENT PRINTING OFFICE: 1958 474734 148

No. 15,987

IN THE

United States Court of Appeals

For the Ninth Circuit

ELMER J. FAUL and SYBELL E. FAUL,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition to Review a Decision of The Tax Court of the United States.

Honorable Ernest H. Van Fossen, Judge.

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

Petitioners' case was presented, with reference to transcript, on pages 2 to 16 of their opening brief. The facts in issue, as given in their opening statement of the case, will not be repeated here.

Respondent's statement of the case (pages 2 to 7 of its brief) is bottomed on the assumption that Revenue Agent Shurlock's testimony, however illogical, unlikely and contrary to common sense, must be accepted as true. There is a further assumption made by respondent's statement of the facts, that the testimony of petitioners' witness, however logical and fair

it may appear, ought to be disregarded. The transcript of the case does not support respondent's contention and does not permit, as we believe, the assumptions made by respondent.

I.

IN SIMPLEST TERMS PETITIONERS CLAIM THAT HUSBAND EXPENDED MORE THAN 36 MONTHS IN PROVIDING RESPONDENT WITH THE INFORMATION ON THE BASIS OF WHICH A TAX DEFICIENCY WAS SUCCESSFULLY ENFORCED.

On pages 20 to 27 of their original brief, petitioners demonstrated that husband contacted the Internal Revenue Service in San Francisco in connection with the alleged fraudulent practices of his employer in February or March 1944; he was advised, and accordingly, he did keep records of the alleged fraudulent practices from that date on. He made copies on his own time, either at his home or late at night at the office. (Tr. 49-50.) In March 1946 husband was discharged from his employment with the fraudulent taxpayer, and in February 1947 he went again to the Internal Revenue Service in San Francisco and again reported about the fraudulent tax practices. Thereupon, he was contacted by Revenue agents to whom he supplied, on the basis of the record copies kept of his former employer's book entries, first about 45, and later another 23 fraud allegations. (Tr. 59, 60, 61 and 79, 80 and 91.) Thereupon, husband worked with the agents until the fall of 1947 and the time spent by him

in gathering and supplying the information covered not less than 43 months. (Tr. 81, 82.)

The evidence adduced by petitioners in their arguments II and III (pages 27 to 35) clearly supports the period of 42 months, during which the information as to the tax fraud was supplied by the husband as the evidence referred to on pages 35 to 42, indicates the time spent by the husband on that score may fairly be held to cover 79 months. In any case, the whole of the testimony, the whole of the record, abundantly proves that the time spent by the husband in supplying information as to the tax fraud was for personal services rendered during a period of not less than 36 months and, therefore, they are entitled to income allocation benefits of Section 107(a) of the 1939 Internal Revenue Code.

II.

RESPONDENT CONTENDS THAT THE TAX COURT FINDING, CONTRARY TO PETITIONERS' CONTENTION IS WARRANTED BY THE RECORD.

Respondent asked this Court to uphold the finding of the Tax Court, notwithstanding, not only the unlikeliness but also the impossibility of Agent Shurlock's testimony. Respondent asks this Court to make assumptions *dehors* the record, and make assumptions which would, in effect, stultify all intendments of the Internal Revenue Code. Respondent apparently contends that even though the husband went to the Internal Revenue Service in March 1944 and informed

an officer thereof that a tax fraud was being practiced by his employer, the Internal Revenue Service had shown no interest in the matter until the evidence was presented on a silver platter in the fall of 1947 in the form of 68 or 70 allegations. (Tr. 60, 61, 79, 80, 91.)

Respondent asks this Court to assume that when the husband was advised by the Internal Revenue Service in the spring of 1944 to make copies of the alleged fraudulent book entries of the employer, that was solely for the protection of the husband with the Service demonstrating no interest whatsoever in using such copies for the purpose of recovering taxes due. (Respondent's Brief, page 11.)

Respondent relies on *Barker v. Shaughnessy* (N.D. N.Y.), 48 A.F.T.R. 1301, 1954. In that case the informant was a tax attorney employed by the fraudulent taxpayer as tax advisor who gathered the information on his employer's time, while here the husband did so on his own time (Tr. 49-50.) Barker was paid to do the tax work for his employer, while the husband here was specifically excluded from the tax work by the employer. (Tr. 46.) Barker first went to the Revenue Service using a fictitious name and discussed a hypothetical case based upon tax irregularities of an unnamed corporation. In the instant case, there is not one iota of evidence that husband didn't give his own name, or that he was discussing a hypothetical case, or that he left the fraudulent taxpayer unnamed. All assumptions based upon the record are to the contrary.

Barker died before the expiration of 36 months from his first visit to the Internal Revenue Service and, in consequence, could not have performed personal services for a period of 36 months or more, while in the instant case the husband could, and did, perform the necessary services to bring about the proof of the tax fraud far longer than 36 months.

District Judge Brennan, now Justice of the Supreme Court of the United States, bases his decision, contrary to the claim of Barker's widow, exactly on the distinction between the *Barker* case and the case now before the Court. The memorandum decision gives the facts as follows:

> "H. Leslie Barker was a tax counsel employed by a large corporation and its twelve associated companies. His employment terminated in February 1943, and it is evident that he had been employed as above for some years prior thereto. On November 23, 1942, Barker, using a fictitious name, discussed with a representative of the Intelligence Unit of the Bureau of Internal Revenue at Washington, a hypothetical case based upon tax irregularities of an unnamed corporation and made inquiry as to the payment of an informer's reward. On March 15, 1943, Mr. Barker called at the New York Office of the Bureau, disclosed his correct identity and the names of the corporations involved, in what he believed to be tax irregularities for the years 1940 and 1941. In April 1943 an investigation was started by the Bureau based upon the facts disclosed by Barker. The investigation was lengthy and no doubt complicated. Barker was occasionally consulted in connection therewith, at least until July

> 18, 1944 when he signed a 'claim for reward' upon the prescribed form, asserting therein his belief that he was entitled to such reward by reason of information furnished by him to Special Agent Sullivan, and other agents associated with him on March 3, 1943 and subsequent dates. The exhibits indicate that the investigation was officially terminated on August 11, 1944 but the final closing was delayed at least two years because of the claims made or the administrative action required.
>
> Mr. Barker died October 17, 1944 and his widow, Helen G. Barker, is the executrix and the sole beneficiary of his estate."

The opinion also sets forth that Barker's estate received an informer's award of $50,000 on November 8, 1948 and an additional amount of $25,000 on February 2, 1949. It is also set forth that Barker's claim for reward was based on

> ". . . information (that) was furnished by me on the 3rd day of March 1943 and subsequent dates . . ."

He died on October 16, 1944 and, therefore, the Court said

> "Even if Barker's services commenced on the occasion of his first visit to Washington on November 3, 1942 and continued until his death on October 16, 1944, the total elapsed time is 13 months short of the 36-month requirement."

In the *Barker* case the Court held that the investigation of the alleged tax fraud by him did not constitute personal services because

"Barker was a full-time employee of a corporation at all the pertinent times herein until February 1943. The nature of his duties is not entirely clear but he is referred to in the stipulated facts as 'tax counsel' and his statement to the agent indicates that he advised or furnished information relative to his employer's tax returns although he may not have had the responsibility for their preparation. His employment was in tax matters and his compensation was earned therefor. It follows that in tax matters his employer alone was entitled to his services rendered in the course of his employment. He may not serve with a divided loyalty. The record here shows that Barker advised the agent that he refused to prepare the 1942 returns because of irregularities which he discovered in the prior returns and that he wrote a letter to his employer to the same effect. We would be naive to conclude that the reasons for such refusal were withheld from the employer. If they were disclosed then the investigation made by Barker must have also been disclosed. In any event it can not be assumed that Barker failed to advise his employer of the discovery of errors or the use of methods designed to enable the consummation of a tax fraud. Here was a large corporation, the actions of the tax or accounting department may well have escaped the attention of the officers or the executive branch. Barker, an experienced and mature attorney-employee, must have known and performed his obligation to his employer. It is fairly inferable that his investigative efforts were made during the course of his employment for which compensation was fully paid. *In effect plaintiff's contention here is for double compen-*

sation over the time period of the investigation without giving effect to the agreed value of the services rendered to and paid by the employer." (Emphasis ours.)

In the *Barker* case it is apparent that even though the Court felt no need to consider it, nevertheless, Section 107(a) was inapplicable because Barker's estate received more than 80 per cent during the year of 1948. In the instant case, that contention was not and could not be raised.

CONCLUSION.

Petitioners respectfully submit that the Tax Court erred in that it construed the applicable law wrongly and its findings of fact are not supported by the evidence, and, therefore, its decision ought to be reversed and it ought to be ordered that petitioners are entitled to the income allocation benefits of Section 107(a) of the 1939 Internal Revenue Code. (26 U.S.C. 1952 Ed. Sec. 107.)

Dated, Carmel, California,
August 16, 1958.

Respectfully submitted,
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